

OFFICIAL STATEMENT DATED DECEMBER 3, 2008

NEW ISSUE: BOOK-ENTRY-ONLY

In the opinion of McCall, Parkhurst & Horton L.L.P., Bond Counsel, interest on the Bonds is excludable from gross income for federal income tax purposes under existing statutes, regulations, published rulings and court decisions existing on the date of such opinion, subject to the matters described under "Tax Matters" herein, including the alternative minimum tax on corporations.



\$209,645,000
Lower Colorado River Authority
Refunding Revenue Bonds, Series 2008A

Dated: December 1, 2008

Due: May 15 as shown on inside front cover

Interest Accrues: Date of Delivery

The Lower Colorado River Authority ("LCRA") Refunding Revenue Bonds, Series 2008A (the "Bonds") are issuable as fully registered bonds in denominations of \$5,000 or any integral multiple thereof. Principal of, and premium, if any, and interest on the Bonds will be payable by the Paying Agent/Registrar, initially The Bank of New York Mellon Trust Company, National Association in Austin, Texas, to the registered owners of the Bonds, as described herein. Interest on the Bonds will accrue from and including their date of delivery and will be payable each May 15 and November 15, commencing May 15, 2009, or upon prior redemption as more fully described herein. When issued, the Bonds will be registered in the name of Cede & Co., nominee of DTC. Purchases of the Bonds will be made in book-entry form only through brokers and dealers who are, or who act through, DTC Participants. Beneficial owners of the Bonds will not be entitled to receive physical delivery of bond certificates so long as DTC or a successor securities depository acts as the securities depository with respect to the Bonds. So long as DTC or its nominee is the registered owner of the Bonds, payments of principal of and premium, if any, and interest on the Bonds will be made directly to DTC. Disbursement of such payments to DTC Participants will be the responsibility of DTC and disbursement of such payments to the beneficial owners is the responsibility of DTC Participants. See "BOOK-ENTRY-ONLY SYSTEM."

The Bonds are subject to redemption prior to maturity, as described herein. See "THE BONDS - Redemption."

Proceeds from the sale of the Bonds will be used to (i) refund certain of LCRA's outstanding Commercial Paper Notes, Tax-Exempt Series A, and (ii) pay certain costs relating to issuance of the Bonds.

The Bonds are limited obligations of LCRA payable solely from and secured by a pledge of the Pledged Revenues. The Bonds do not constitute a general indebtedness of LCRA, the State of Texas or any other political subdivision of such State, within the meaning of any constitutional, statutory, or charter provision or limitation. Neither the faith and credit nor the taxing power of the State of Texas, or any other political subdivision of such State is pledged to the payment of the Bonds. LCRA has no taxing power.

Maturity Schedule
(See inside front cover)

The Bonds are offered when, as and if issued, and subject to the approval of the Attorney General of the State of Texas and the approval of McCall, Parkhurst & Horton L.L.P., Austin and Dallas, Texas, Bond Counsel. Certain legal matters in connection with the Bonds will be passed upon by Hawkins Delafield & Wood LLP, Sacramento, California, Counsel to the Underwriters. It is expected that the Bonds will be available for delivery through the facilities of DTC in New York, New York, on or about December 18, 2008.

Morgan Stanley & Co. Incorporated

Barclays Capital Inc.

First Southwest Company

Goldman, Sachs & Co.

J.P. Morgan

Merrill Lynch & Co.

Rice Financial Products Company

Wachovia Bank, National Association

MATURITY SCHEDULE

<u>Maturity (May 15)</u>	<u>Principal Amount^(a)</u>	<u>Interest Rate</u>	<u>Yield or Price</u>	<u>CUSIP Numbers^(b)</u>
2009	\$ 1,920,000	4.00%	2.00%	54810CYQ7
2010	4,780,000	4.00	3.05	54810CYR5
2011	3,550,000	5.00	3.42	54810CYS3
2012	2,600,000	5.00	3.75	54810CYT1
2013	300,000	5.00	3.95	54810CYU8
2014	5,005,000	5.00	4.15	54810CYV6
2015	6,300,000	5.00	4.35	54810CYW4
2016	6,200,000	5.00	4.60	54810CYX2
2017	500,000	5.00	4.85	54810CYY0
2018	8,305,000	5.00	5.03	54810CYZ7
2019	8,200,000	5.50	5.30*	54810CZA1
2020	7,735,000	5.75	5.55*	54810CZB9

\$15,225,000 5.75% Term Bonds Due May 15, 2023 - Priced to Yield 6.05% CUSIP No.^(b) 54810CZC7

\$32,525,000 6.25% Term Bonds Due May 15, 2028 - Priced to Yield 6.40% CUSIP No.^(b) 54810CZD5

\$42,500,000 6.25% Term Bonds Due May 15, 2031 - Priced to Yield 6.60% CUSIP No.^(b) 54810CZE3

\$37,000,000 6.50% Term Bonds Due May 15, 2037 - Priced to Yield 6.80% CUSIP No.^(b) 54810CZF0

\$27,000,000 7.25% Term Bonds Due May 15, 2037 - Priced to Yield 6.80%** CUSIP No.^(b) 54810CZG8

(Interest Accrues from Date of Delivery)

* Priced to par call on May 15, 2018.

** Priced to par call on May 15, 2015.

^(a) LCRA reserves the right, at its option, to redeem Bonds having stated maturities on and after May 15, 2019, other than the Bonds maturing on May 15, 2037, in whole or in part, in principal amounts of \$5,000 or integral multiples thereof, on May 15, 2018, or any date thereafter, at a redemption price equal to the principal amount of such Bonds to be redeemed, plus accrued interest to the redemption date. LCRA reserves the right, at its option, to redeem Bonds having a stated maturity on May 15, 2037, in whole or in part, in principal amounts of \$5,000 or integral multiples thereof, on May 15, 2015, or any date thereafter, at a redemption price equal to the principal amount of such Bonds to be redeemed, plus accrued interest to the redemption date. Additionally, the Bonds maturing May 15, 2023, May 15, 2028, May 15, 2031, May 15, 2037 which bear interest at a rate of 6.50% per annum and May 15, 2037 which bear interest at a rate of 7.25% per annum are subject to mandatory sinking fund redemption. See "THE BONDS - Redemption."

^(b) CUSIP numbers have been assigned to this issue by the Standard & Poor's CUSIP Service Bureau, a division of the McGraw-Hill Companies, Inc., and are included solely for the convenience of the owners of the Bonds. Neither LCRA nor the Underwriters shall be responsible for the selection or correctness of the CUSIP numbers set forth herein.

- WHOLESALE ELECTRIC CUSTOMERS**
- ELECTRIC COOPERATIVES**
- Hallettsville
 - Bandera
 - Bluebonnet
 - Central Texas
 - Fayette
 - Guadalupe Valley
 - Hamilton County
 - Pedernales
 - San Bernard
- CITY UTILITIES**
- Bastrop Power & Light
 - Bellville
 - Boerne
 - Brady
 - Brenham
 - Burnet
 - Cuero
 - Flotonia
 - Fredricksburg
 - Georgetown Utility Systems
 - Giddings
 - Goldthwaite
 - Gonzales
- OTHER**
- Cap Rock Energy Corp.

- MAJOR WATER CONTRACT CUSTOMERS**
- Bastrop Energy Partners
 - Blanco San Miguel Corporation
 - Brazos River Authority
 - Calanese Chemical Group, Inc.
 - City of Austin
 - City of Burnet
 - City of Cedar Park
 - City of Horseshoe Bay
 - City of Lago Vista
 - City of Leander
 - City of Marble Falls
 - City of Pflugerville
 - Equisar Chemicals
 - Fayette Power Project
 - Thomas C. Ferguson Power Plant
 - Hurst Creek Municipal Utility District (MUD)
- Jonestown Water Supply Corporation
 - Lakeway MUD
 - Northside MUD
 - Lost Pines Power Park
 - RiverPlace MUD
 - South Central Water Co.
 - South Texas Project Electric Generating Station
 - Texas Brine Corporation
 - Travis County MUD No. 4
 - Travis County MUD No. 11
 - Travis County Water Control and Improvement Districts 17, 18 and 20
 - West Cypress Hills
 - West Travis County Regional Water System

- WATER AND WASTEWATER SERVICE FACILITIES BY COUNTY**
- BASTROP COUNTY**
- Camp Swift Regional Wastewater System
 - Elgin Wastewater System
 - McKinney Roughs Wastewater System
 - Tahitian Village Wastewater System
- BURNET COUNTY**
- Bonanza Beach Water System
 - Hamilton Creek Water System
 - Highland Lakes Regional Biosolids Composting Facility
 - Quail Creek Water System
 - Ridge Harbor Water and Wastewater Systems
 - Smithwick Mills Water System
 - South Road Water System
 - Spicewood Beach Water System
 - Whitewater Springs Water System
- COLORADO COUNTY**
- Alleyton Wastewater System
- GILLESPIE COUNTY**
- Harper Water System
- KIMBLE COUNTY**
- London Water System
- LAMPASAS COUNTY**
- Lometa Regional Water and Wastewater Systems
- LLANO COUNTY**
- Bridgpoint Water System
 - Lake Buchanan Water System
 - Paradise Point Water System
 - Sandy Harbor Water System
 - Sunrise Beach Water System
 - Tow Village Water System
- MATAGORDA COUNTY**
- Matagorda Dunes Water System
 - Ridge Harbor Water and Wastewater Systems
 - Smithwick Mills Water System
 - South Road Water System
 - Spicewood Beach Water System
 - West Lake Hills Wastewater System
 - Whitewater Springs Water System
- TRAVIS COUNTY**
- Glenlake Water System
 - Lakeway Raw Water Intake
 - Rollingwood Wastewater System
 - West Lake Hills Wastewater System
 - West Travis County Regional Water and Wastewater Systems
- WILLIAMSON COUNTY**
- Brushy Creek Regional Wastewater System
 - Hutto Wastewater System
 - Leander Water System
 - Liberty Hill Wastewater System

LCRA Customer Service Area 2008

Service Area Symbols

- Colorado River
- Electric Cooperative Headquarters City
- Electric Customer City
- Major Water Contract Customer
- Water and/or Wastewater Facility
- Park or Preserve
- Electric Cooperative Boundary
- Authorized Water Service Area
- Irrigation Service Area

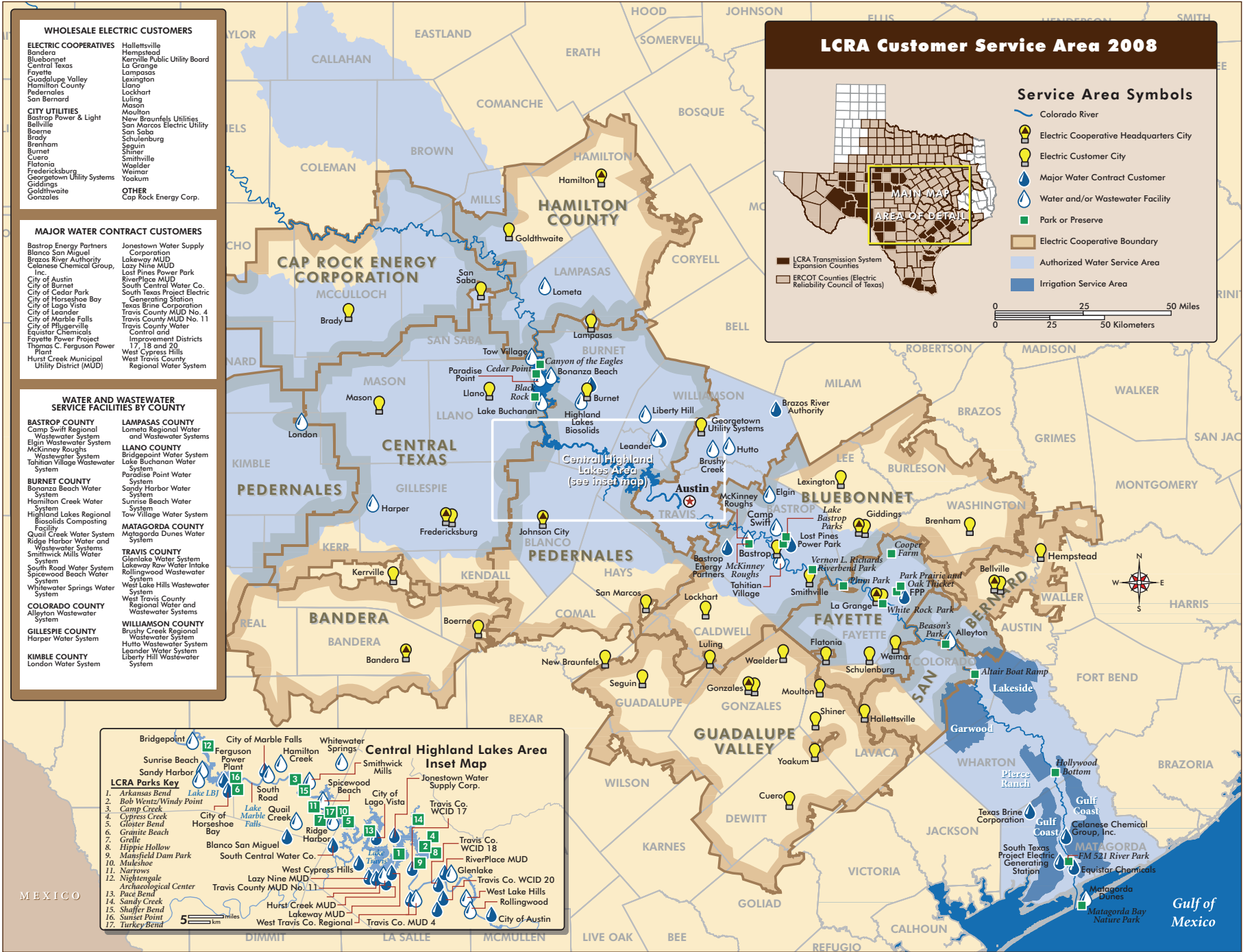
LCRA Transmission System Expansion Counties
ERCOT Counties (Electric Reliability Council of Texas)

0 25 50 Miles
0 25 50 Kilometers

Central Highland Lakes Area Inset Map

LCRA Parks Key

- Arkansas Bend
- Bab Wentz/Windy Point
- Camp Creek
- Cypress Creek
- Gloster Bend
- Granite Beach
- Greble
- Hippie Hollow
- Mansfield Dam Park
- Mulshoe
- Narrows
- Nightengale Archaeological Center
- Pace Bend
- Sandy Creek
- Shaffer Bend
- Sunset Point
- Turkey Bend



LOWER COLORADO RIVER AUTHORITY

BOARD OF DIRECTORS

REBECCA A. KLEIN, Chair

CLAYBORNE L. NETTLESHIP, Vice Chair

LINDA C. RAUN, Secretary

BRENDA ADAIR
STEVE K. BALAS
KAY CARLTON
IDA A. CARTER
JOHN C. DICKERSON III
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KATHLEEN HARTNETT WHITE
LUCY WILKE

KEY OFFICERS

THOMAS G. MASON
W. BRADY EDWARDS
JOHN W. RUBOTTOM
CHARLIE JOHNSON
JIM TRAVIS
CRAIG SLOAN

General Manager and Chief Executive Officer
Chief Financial Officer
General Counsel
General Auditor
Treasurer
Controller

BOND COUNSEL AND SECURITIES COUNSEL

McCall, Parkhurst & Horton L.L.P.

INDEPENDENT AUDITORS

Deloitte & Touche LLP

FINANCIAL ADVISOR

OBP Muni LLC

No dealer, broker, salesman, or other person has been authorized by LCRA or by the Underwriters to give any information or to make any representation, other than as contained in this Official Statement, and if given or made such other information or representations must not be relied upon as having been authorized by LCRA or the Underwriters. This Official Statement does not constitute an offer to sell or the solicitation of an offer to buy, nor shall there be any sale of the Bonds by any person, in any jurisdiction in which it is unlawful for such persons to make such offer, solicitation or sale.

The information set forth herein has been furnished by LCRA and includes information obtained from other sources which are believed to be reliable. The information and expressions of opinion contained herein are subject to change, without notice, and neither the delivery of this Official Statement nor any sale made hereunder shall, under any circumstances, create any implication that there has been no change in the affairs of LCRA or the other matters described herein since the date hereof.

THE UNDERWRITERS MAY OVERALLOT OR EFFECT TRANSACTIONS WHICH STABILIZE OR MAINTAIN THE MARKET PRICE OF THE BONDS AT A LEVEL ABOVE THAT WHICH MIGHT OTHERWISE PREVAIL IN THE OPEN MARKET. THE UNDERWRITERS ARE NOT OBLIGATED TO DO SO AND ARE FREE TO DISCONTINUE SUCH STABILIZING, IF COMMENCED, AT ANY TIME.

The Underwriters have provided the following sentence for inclusion in this Official Statement. The Underwriters have reviewed the information in this Official Statement in accordance with, and as part of, their responsibilities to investors under the federal securities laws as applied to the facts and circumstances of this transaction, but the Underwriters do not guarantee the accuracy or completeness of such information.

NEITHER LCRA NOR THE UNDERWRITERS MAKE ANY REPRESENTATION AS TO THE ACCURACY, COMPLETENESS, OR ADEQUACY OF THE INFORMATION SUPPLIED BY THE DEPOSITORY TRUST COMPANY FOR USE IN THIS OFFICIAL STATEMENT.

The statements contained in this Official Statement, and in any other information provided by LCRA, that are not purely historical, are forward-looking statements, including statements regarding LCRA's expectations, hopes, intentions, or strategies regarding the future. All forward-looking statements included in this Official Statement are based on information available to LCRA on the date hereof, and LCRA assumes no obligation to update any such forward-looking statements. See "FACTORS TO BE CONSIDERED IN INVESTING IN THE BONDS - Forward-Looking Statements."

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\$209,645,000
LOWER COLORADO RIVER AUTHORITY
REFUNDING REVENUE BONDS,
SERIES 2008A

INTRODUCTION

This Official Statement, which includes the cover page and appendices hereto, sets forth certain information regarding the issuance by the Lower Colorado River Authority ("LCRA") of its \$209,645,000 Refunding Revenue Bonds, Series 2008A (the "Bonds").

The Bonds are being issued pursuant to a Master Resolution adopted by the Board of Directors of LCRA (the "LCRA Board") on September 22, 1999 (the "Master Resolution") establishing LCRA's Revenue Financing Program and pursuant to a Twenty-Eighth Supplemental Resolution to the Master Resolution (the "Twenty-Eighth Supplement") adopted by the LCRA Board on October 15, 2008. The Master Resolution and the Twenty-Eighth Supplement are sometimes hereinafter collectively referred to as the "Resolution." Capitalized terms used in this Official Statement (except in APPENDIX C - "LCRA TRANSMISSION SERVICES CORPORATION") and not otherwise defined herein shall have the meanings ascribed to them in APPENDIX A - "SUMMARY OF CERTAIN PROVISIONS OF THE RESOLUTION - Definitions."

The Master Resolution establishes a comprehensive program to accommodate the issuance or incurrence of different types of obligations that are secured by a lien on and pledge of the Pledged Revenues on parity with the lien thereon that secures other issues of debt, including the Bonds, and other payment obligations of LCRA from time to time issued or incurred under the Master Resolution ("Parity Debt"). See "THE BONDS - Security for the Bonds" and "DESCRIPTION OF THE REVENUE FINANCING PROGRAM."

OVERVIEW OF LCRA

LCRA is a conservation and reclamation district created by the State Legislature in 1934. LCRA is a governmental entity and body politic and corporate of the State without taxing power. The statutory boundaries of LCRA encompass a ten-county district consisting of the counties of Bastrop, Blanco, Burnet, Colorado, Fayette, Llano, Matagorda, San Saba, Travis and Wharton. Legislation governing LCRA also allows LCRA to exercise most of its statutory district powers in Lampasas County and limited water-related powers in Williamson County. LCRA currently is authorized directly or through its Affiliates, among other things, to control, store, preserve, use, distribute and sell the waters of the Colorado River for useful purposes; to develop, generate, distribute and sell hydroelectric and thermal electric power and energy in all or parts of a 54 county service area of central Texas; to study, correct and control both artificial and natural pollution of the waters of the Colorado River within its boundaries; and to develop and manage parks and recreational facilities. Rising in Dawson County in west Texas, the Colorado River flows about 600 miles in a southeasterly direction until it reaches Matagorda Bay, southwest of Houston. In addition to providing electric generation within its 54 county electric service area, LCRA is authorized, either directly or through the use of Affiliates, to provide electric generation and transmission service throughout the State.

LCRA's mission is to provide reliable, low-cost utility and public services in partnership with its customers and communities and to use its leadership role and environmental authority to ensure the protection and constructive use of the natural resources within its statutory boundaries.

LCRA has developed and implemented its business structure and management policies to respond to regulatory, market and regional issues, such as electric industry restructuring and continued economic and population growth in central Texas. This evolution has positioned LCRA as a low-cost wholesale energy services provider and a cost-efficient provider of other services. LCRA's operations are currently organized into four separate business units (each a "Business Unit"): Wholesale Power Services (electric generation); Transmission Services (electric transmission); Water Services (river management and water and wastewater utility services); and Community Services (parks and land resources, natural resource management and community and economic development). LCRA also

operates through the following Affiliates: the LCRA Transmission Services Corporation ("TSCorp"), the GenTex Power Corporation ("GenTex") and the LCRA Wholesale Energy Services Corporation ("LCRA Energy"). See "OVERVIEW OF LCRA OPERATIONS - Affiliates - *LCRA Transmission Services Corporation*," "WHOLESALE POWER SERVICES - GenTex," "- LCRA Wholesale Energy Services Corporation" and APPENDIX C - "LCRA TRANSMISSION SERVICES CORPORATION."

LCRA, through its Wholesale Power Services Business Unit, provides wholesale electricity to eight electric cooperatives, one investor owned utility (that acquired an electric cooperative customer of LCRA) and 34 cities that combined serve more than one million people in all or part of 54 counties in central Texas. A map illustrating LCRA's service areas and a list of its wholesale electric customers appears on page ii of this Official Statement. LCRA's management attributed approximately 88% of LCRA's revenues to Wholesale Power Services for the Fiscal Year ended June 30, 2008. LCRA currently has approximately 2,875 megawatts ("MW") of net dependable electric generating capacity, including 500 MW of generating capacity available pursuant to contracts with GenTex. See "WHOLESALE POWER SERVICES - GenTex." LCRA's generation costs are competitive within ERCOT as a result of a diversified generation portfolio, competitive fuel costs and an active management style. LCRA supplements its available generation capacity through power purchases.

LCRA has historically provided wholesale electricity to its wholesale electric customers pursuant to requirements wholesale power agreements. See "WHOLESALE POWER SERVICES – Wholesale Power Agreements - *General*." The agreements contain certain provisions which give the customers various rights to limited reductions in the amount of their respective loads served by LCRA under certain circumstances. See "Wholesale Power Services - Wholesale Power Agreements - *Amendment of Wholesale Power Agreements*" and "*- Options under the Original Agreements*" and "*- Wholesale Energy Pricing Program*." Under LCRA's historical wholesale power agreements, the parties have the right to terminate their respective agreements on June 25, 2016 by giving notice not later than June 25, 2011. If neither party gives a notice to terminate by such date, the term of the respective wholesale power agreements automatically continues until June 25, 2041. LCRA has executed amendments to its wholesale power agreements with 31 of its wholesale electric customers representing approximately 61% of its load served in the fiscal year ended June 30, 2008, which include the waiver of such termination provisions thereby allowing such agreements to continue until June 25, 2041. Such amendments have provided certain customers with the right to further reduce their respective loads served by LCRA by as much as 35%. LCRA is currently in discussions with its remaining wholesale electric customers regarding their agreements and may also execute amendments to such agreements in the future. Such amendments may result in some of LCRA's wholesale electric customers having the ability to purchase more of their electric requirements from other suppliers as well as other potential changes. See "WHOLESALE POWER SERVICES – Wholesale Power Agreements - *Amendment of Wholesale Power Agreements*."

While such negotiations continue with the remaining wholesale electric customers, LCRA has determined to pursue additional generation resources. LCRA is constructing four new 45 MW gas-fired, combustion turbine peaking generation units near Winchester, Texas that are anticipated to be operational by summer 2009. Additionally, LCRA has signed a participation agreement with LS Power for a 100 MW equity ownership interest in the Sandy Creek Project pulverized coal facility (the "Sandy Creek Project") near Waco, Texas, and a 100 MW long-term power supply agreement from the same facility, which is anticipated to be operational by summer 2012. Also, subject to successful negotiation of a related joint participation agreement, LCRA has elected a 300 MW ownership interest in an NRG Texas LP coal-fired electric generation unit ("Limestone Unit 3") in Limestone County, Texas. See "WHOLESALE POWER SERVICES – Generating and Related Resources - *New and Proposed Additional Generation Facilities*" and "*- Capital Improvements*."

In June 1999, the State Legislature adopted legislation, known as Senate Bill 7 ("SB 7"), that restructured the State's electric utility industry, including mandating retail competition on January 1, 2002 for the customers of the investor-owned utilities located within the area of the State covered by the Electric Reliability Council of Texas ("ERCOT"), which accounts for approximately 85% of the State's electric load, and for the customers of those municipal utilities and electric cooperatives within the ERCOT region that elect to open their service areas to competition. See "REGULATORY MATTERS - SB 7." The State's electric industry within ERCOT opened to retail competition on January 1, 2002. None of LCRA's 43 current wholesale electric customers, however, have given notice to the Public Utility Commission of Texas (the "PUC") of their intention to opt into open retail competition. In 2002, LCRA's largest wholesale customer, Pedernales Electric Cooperative, Inc. ("PEC") indicated that it planned to opt in to retail competition at some undetermined date, but to date, PEC has not publically taken any steps to

implement such plans. LCRA's management believes that LCRA is well positioned to compete in an open market electric utility environment based on a number of factors, including reliable and well managed generating units and a favorable overall cost structure.

As a result of SB 7, on January 1, 2002 LCRA transferred its electric transmission and transformation facilities to TSCorp, and TSCorp now provides electric transmission services to utilities, including LCRA and its wholesale electric customers, that operate within the region of the State covered by ERCOT. LCRA's Transmission Services Business Unit provides the personnel and staffing services for TSCorp under a services contract between TSCorp and LCRA. See "OVERVIEW OF LCRA OPERATIONS - Affiliates - *LCRA Transmission Services Corporation*," "TRANSMISSION SERVICES" and APPENDIX C - "LCRA TRANSMISSION SERVICES CORPORATION."

LCRA, through its Water Services Business Unit, manages water supplies and flooding along the lower Colorado River in the State. Water Services operates six dams that form the Highland Lakes (Lakes Buchanan, Inks, LBJ, Marble Falls, Travis and Austin) and contain LCRA's hydroelectric generating facilities. LCRA's water service area covers approximately 20,000 square miles in all or part of 33 counties. LCRA has emphasized the development of its water and wastewater utility operations, through Water Services, in order to meet the demand for water related services and new water supplies. In fulfilling its statutory mission in this area, LCRA is providing regional and local water and wastewater utility service, including the construction, acquisition and operation of water and wastewater treatment facilities and systems, as well as securing water rights on the Colorado River. See "WATER SERVICES."

LCRA's Community Service Business Unit provides central Texas with parks, agricultural and wildlife conservation services, and natural resource management services. LCRA has also developed, funded and implemented, through its Community Services Business Unit, community and economic development services and environmental programs that improve the water quality of the lower Colorado River and the growth of rural tourism in the region, among other benefits. While the results of such programs only indirectly affect LCRA's financial condition, its regional service efforts are a critical part of meeting LCRA's statutory mission.

The foregoing "OVERVIEW OF LCRA" is not intended to be and is not a complete discussion of the matters mentioned therein or of LCRA. Reference is made to this entire Official Statement for all information LCRA management believes to be material to any decision regarding the purchase of the Bonds. LCRA's Business Units are described under "OVERVIEW OF LCRA OPERATIONS - Business Units." LCRA's electric generation, electric transmission, water and wastewater activities, corporate services and community services are described under "OVERVIEW OF LCRA OPERATIONS - Affiliates - *LCRA Transmission Services Corporation*," "WHOLESALE POWER SERVICES," "TRANSMISSION SERVICES," APPENDIX C - "LCRA TRANSMISSION SERVICES CORPORATION," "WATER SERVICES," and "COMMUNITY SERVICES," respectively. LCRA's business policies and approach to changes in the electric utility industry are described under "LCRA FINANCIAL POLICIES, BUSINESS PLAN AND CAPITAL BUDGET - Financial Policies and Business Plan - *Rates and Prices*," "WHOLESALE POWER SERVICES - Approach to Operations and Business," and "REGULATORY MATTERS - SB 7," respectively. See also "FACTORS TO BE CONSIDERED IN INVESTING IN THE BONDS."

MANAGEMENT OF LCRA

Pursuant to the LCRA Act, the powers, rights, privileges and functions of LCRA are exercised by the LCRA Board. In this regard, the LCRA Board has the responsibility for, and the authority to establish, policies to guide the management of LCRA's affairs. The LCRA Board is composed of fifteen members. The directors are all appointed for staggered six-year terms by the Governor of the State with confirmation by the State Senate. Twelve directors are selected from the ten-county area which forms the statutory district. Three at-large directors are selected from the counties served with electric power and energy outside the boundaries of LCRA. The Chair of the LCRA Board is appointed by the Governor of the State and the Vice-Chair and the Secretary of the LCRA Board are elected by the LCRA Board from its membership.

The bylaws of LCRA provide that the General Manager, who serves at the pleasure of the LCRA Board, is the chief executive officer of LCRA. The General Manager is obligated to keep the LCRA Board fully and currently informed of the business and activities of LCRA and to act pursuant to policies of the LCRA Board. The other

officers of LCRA are under the direction of the General Manager. The General Counsel and General Auditor are hired by the LCRA Board in consultation with the General Manager, and report to both the LCRA Board and the General Manager.

Key Officials

<u>Name</u>	<u>Position</u>	<u>Utility Experience (in years)</u>
Thomas G. Mason	General Manager and Chief Executive Officer	26
W. Brady Edwards	Chief Financial Officer	17
John W. Rubottom	General Counsel	27
Charlie Johnson	General Auditor	2
Jim Travis	Treasurer	16
Craig Sloan	Controller	10

PURPOSE OF FINANCING

Purpose of the Bonds

LCRA is issuing the Bonds for the purpose of (i) currently refunding certain of its outstanding Commercial Paper Notes, Tax-Exempt Series A in the approximate aggregate principal amount of \$205.5 million (the "Refunded Obligations") and (ii) paying certain issuance costs related to the Bonds. See "THE BONDS" and "SOURCES AND USES OF FUNDS."

The Refunded Obligations

The Resolution provides that an amount sufficient to defease the Refunded Obligations shall be deposited into the note payment fund relating to Refunded Obligations held by The Bank of New York Mellon Trust Company, National Association, the paying agent for the Refunded Obligations. The Refunded Obligations will be retired on the date of the initial delivery of the Bonds.

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SOURCES AND USES OF FUNDS

LCRA estimates that the proceeds from the sale of the Bonds, together with other funds of LCRA, will be applied as set forth in the following table:

Sources of Funds:

Principal Amount of Bonds	\$ 209,645,000.00
Net Discount on the Bonds	(2,354,676.20)
LCRA Contribution	<u>82,387.29</u>
Total Sources of Funds	<u>\$ 207,372,711.09</u>

Uses of Funds:

Deposit to the note payment fund for the Refunded Obligations	\$ 205,582,387.29
Underwriters' Discount	1,326,677.41
Costs of Issuance	<u>463,646.39</u>
Total Uses of Funds	<u>\$ 207,372,711.09</u>

THE BONDS

General

The Bonds are being issued in accordance with the Acts and the Resolution. The Bonds and any additional Parity Debt issued in the future will be equally and ratably secured by a lien on and pledge of the Pledged Revenues. Under the terms of the Master Resolution, LCRA reserves the right and will have the power to issue additional Parity Debt, Subordinate Lien Obligations and other indebtedness. See "DESCRIPTION OF THE REVENUE FINANCING PROGRAM - Outstanding and Additional Debt - *Additional Debt.*"

The Bonds will be issued only as fully registered bonds, without coupons. The Bonds are issued in principal denominations of \$5,000 or any integral multiple thereof within a maturity. The Bonds will mature on the dates, in the principal amounts and accrue interest at the per annum rates set forth on the inside cover page of this Official Statement.

Interest on the Bonds shall be payable to the owners of such Bonds whose names appear in the Security Register on the close of business on the last business day of the month next preceding each May 15 and November 15 (each an "Interest Payment Date"). LCRA shall cause such accrued interest to be paid (i) by check sent United States Mail, first class postage prepaid to the address of the owners recorded in the Security Register or (ii) by such other method, acceptable to the Paying Agent/Registrar. Principal of the Bonds will be payable only upon presentation of the Bonds to the Paying Agent/Registrar.

In the event of a nonpayment of interest on a scheduled payment date on the Bonds, and for thirty (30) days thereafter, a new record date for such interest payment (a "Special Record Date") will be established by the Paying Agent/Registrar, if and when funds for the payment of such interest have been received from LCRA. Notice of the Special Record Date and of the scheduled payment date of the past due interest (which shall be fifteen (15) days after the Special Record Date) shall be sent at least five (5) business days prior to the Special Record Date by United States Mail, first-class postage prepaid, to the address of each

owner of a Bond appearing on the Security Register at the close of business on the last business day next preceding the date of mailing of such notice.

In the event that any date for payment of the principal of or interest on the Bonds is a Saturday, Sunday, legal holiday, or day on which banking institutions in the city where the Paying Agent/Register is located are authorized by law or executive order to close, then the date for such payment will be the next succeeding day which is not a Saturday, Sunday, legal holiday, or day on which such banking institutions are authorized to close. Payment on such later date will not increase the amount of interest due and will have the same force and effect as if made on the original date payment was due.

Redemption

Mandatory Sinking Fund Redemption. The Bonds maturing May 15, 2023, May 15, 2028, May 15, 2031, May 15, 2037 which bear interest at a rate of 6.50% per annum and May 15, 2037 which bear interest at a rate of 7.25% per annum will be subject to mandatory sinking fund redemption prior to maturity on May 15 in each of the following years and in the following amounts at the redemption price equal to the principal amount thereof plus accrued interest to the redemption date, with the particular Bonds or portions thereof to be redeemed, to be selected and designated by LCRA (provided that a portion of a Bond may be redeemed only in an integral multiple of \$5,000):

5.75% Term Bonds Due May 15, 2023	
<u>Redemption Date</u>	<u>Amount</u>
May 15, 2022	\$7,400,000
May 15, 2023*	7,825,000
<hr/>	
*Final maturity	

6.25% Term Bonds Due May 15, 2028	
<u>Redemption Date</u>	<u>Amount</u>
May 15, 2024	\$5,740,000
May 15, 2025	6,100,000
May 15, 2026	6,480,000
May 15, 2027	6,885,000
May 15, 2028*	7,320,000
<hr/>	
*Final maturity	

6.25% Term Bonds Due May 15, 2031	
<u>Redemption Date</u>	<u>Amount</u>
May 15, 2029	\$13,315,000
May 15, 2030	14,150,000
May 15, 2031*	15,035,000
<hr/>	
*Final maturity	

6.50% Term Bonds Due May 15, 2037	
<u>Redemption Date</u>	<u>Amount</u>
May 15, 2032	\$5,240,000
May 15, 2033	5,580,000
May 15, 2034	5,940,000
May 15, 2035	6,325,000
May 15, 2036	6,740,000
May 15, 2037*	7,175,000
<hr/>	
*Final maturity	

7.25% Term Bonds Due May 15, 2037

<u>Redemption Date</u>	<u>Amount</u>
May 15, 2032	\$3,750,000
May 15, 2033	4,025,000
May 15, 2034	4,315,000
May 15, 2035	4,625,000
May 15, 2036	4,965,000
May 15, 2037*	5,320,000

*Final maturity

The principal amount of the Bonds subject to mandatory sinking fund redemption will be reduced, at the option of LCRA, by the principal amount of any Bonds which, at least 50 days prior to the mandatory sinking fund redemption date, have been (i) acquired by LCRA and delivered to the Paying Agent/Registrar for cancellation, or (ii) redeemed pursuant to the optional redemption provisions and not theretofore credited against a mandatory redemption requirement.

Optional Redemption. The Bonds that mature on and after May 15, 2019, other than the Bonds maturing on May 15, 2037, are redeemable at the option of LCRA, on May 15, 2018 or on any date thereafter, in whole or in part, in principal amounts of \$5,000 or integral multiples thereof (and, if in part, the particular Bonds or portions thereof to be redeemed shall be selected by LCRA in its sole discretion) at a redemption price equal to the principal amount of such Bonds to be redeemed, plus accrued interest to the redemption date.

The Bonds that mature on May 15, 2037 are redeemable at the option of LCRA, on May 15, 2015 or on any date thereafter, in whole or in part, in principal amounts of \$5,000 or integral multiples thereof (and, if in part, the particular Bonds or portions thereof to be redeemed shall be selected by LCRA in its sole discretion) at a redemption price equal to the principal amount of such Bonds to be redeemed, plus accrued interest to the redemption date.

LCRA may retain its optional redemption rights in the event of the defeasance to maturity of the Bonds that are subject to optional redemption. See "THE BONDS - Defeasance."

Notice of Redemption and Defeasance. LCRA shall give notice of redemption or defeasance to the Paying Agent/Registrar at least thirty-five (35) days prior to a redemption date in the case of a redemption and on the defeasance date in the case of a defeasance (unless a lesser period is acceptable to the Paying Agent/Registrar), and the Paying Agent/Registrar shall give notice of redemption or of defeasance of Bonds by mail, first-class postage prepaid, at least thirty (30) days prior to a redemption date and within thirty (30) days after a defeasance date to each registered securities depository and to any national information service that disseminates such notices. In addition, in the event of a redemption caused by an advance refunding of the Bonds, the Paying Agent/Registrar shall send a second notice of redemption to the persons specified in the immediately preceding sentence at least thirty (30) days but not more than ninety (90) days prior to the actual redemption date. Any notice sent to the registered securities depositories or such national information services shall be sent so that they are received at least two (2) days prior to the general mailing or publication date of such notice. The Paying Agent/Registrar shall also send a notice of prepayment or redemption to the owner of any Bond who has not sent the Bonds in for redemption sixty (60) days after the redemption date.

With respect to any optional redemption of the Bonds, unless certain prerequisites to such redemption required by the Master Resolution or the Twenty-Eighth Supplement have been met and moneys sufficient to pay the principal of and premium, if any, and interest on the Bonds to be redeemed shall have been received by the Paying Agent prior to the giving of such notice of redemption, such notice shall state that said redemption may, at the option of LCRA, be conditional upon the satisfaction of such prerequisites and receipt of such moneys by the Paying Agent on or prior to the date fixed for such redemption, or upon any prerequisite set forth in such notice of redemption. If a conditional notice of redemption is given and such

prerequisites to the redemption and sufficient moneys are not received, such notice shall be of no force and effect, LCRA shall not redeem such Bonds and the Paying Agent shall give notice, in the manner in which the notice of redemption was given, to the effect that the Bonds have not been redeemed.

During any period in which ownership of the Bonds is determined by a book-entry at a securities depository for the Bonds, if fewer than all of the Bonds of the same maturity and bearing the same interest rate are to be redeemed, the particular Bonds of such maturity and bearing such interest rate will be selected in accordance with the arrangements between LCRA and the securities depository.

Defeasance

The Resolution provides for the defeasance of the Bonds when the payment of the principal of and premium, if any, on the Bonds, plus interest thereon to the due date thereof (whether such due date be by reason of maturity, redemption, or otherwise), is provided by irrevocably depositing with a paying agent, in trust (1) money sufficient to make such payment or (2) Government Obligations, certified by an independent public accounting firm of national reputation to mature as to principal and interest in such amounts and at such times to insure the availability, without reinvestment, of sufficient money to make such payment, and all necessary and proper fees, compensation and expenses of the paying agent for the Bonds being defeased. "Government Obligations" means (a) direct, noncallable obligations of the United States of America, including obligations that are unconditionally guaranteed by the United States of America (including interest strips of the Resolution Funding Corporation), (b) noncallable obligations of an agency or instrumentality of the United States of America, including obligations that are unconditionally guaranteed or insured by the agency or instrumentality and that are rated as to investment quality by a nationally recognized investment rating firm not less than AAA or its equivalent, and (c) noncallable obligations of a state or an agency or a county, municipality, or other political subdivision of a state that have been refunded and that are rated as to investment quality by a nationally recognized investment rating firm not less than AAA or its equivalent. LCRA has additionally reserved the right, subject to satisfying the requirements of (1) and (2) above, to substitute other Government Obligations for the Government Obligations originally deposited, to reinvest the uninvested moneys on deposit for such defeasance and to withdraw for the benefit of LCRA moneys in excess of the amount required for such defeasance.

Upon such deposit as described above, such Bonds shall no longer be regarded as outstanding or unpaid. LCRA may reserve the option at the time of the defeasance of any Bonds to call for redemption, at an earlier date, Bonds that have been defeased to their maturity date, if LCRA: (i) in the proceedings providing for the defeasance, expressly reserves the right to call such Bonds for redemption; (ii) gives notice of the reservation of that right to the owners of such Bonds immediately following the making of the firm banking and financial arrangements; (iii) directs that notice of the reservation be included in any redemption notices authorized by LCRA; and (iv) at the time of the redemption, satisfies the conditions of the preceding paragraph with respect to such Bonds as though it was being defeased at the time of the exercise of the option to redeem the Bonds, after taking the redemption into account in determining the sufficiency of the provisions made for the payment of the Bonds.

Paying Agent/Registrar

LCRA covenants to maintain and provide a Paying Agent/Registrar at all times while the Bonds are outstanding, and any successor Paying Agent/Registrar must be a bank, trust company, financial institution or other entity duly qualified and legally authorized to serve and perform the duties and services of Paying Agent/Registrar. The initial Paying Agent/Registrar for the Bonds is The Bank of New York Mellon Trust Company, National Association. LCRA reserves the right to appoint one or more successor Paying Agent/Registrars and expressly reserves the right to terminate the appointment of the Paying Agent/Registrar by filing a certified copy of a resolution of the LCRA Board giving notice of LCRA's termination of its agreement with such Paying Agent/Registrar. Upon any change in the Paying Agent/Registrar, LCRA will either promptly cause a written notice thereof to be sent to each owner by

United States mail, first-class, postage prepaid, which notice will also give the address of the new successor Paying Agent/Registrar.

Security for the Bonds

Parity Debt. The Bonds are Parity Debt under the Master Resolution and constitute special obligations of LCRA payable from and secured by a lien on and pledge of Pledged Revenues (including payments received by LCRA from TSCorp under the Initial Contractual Commitment), subject only to any provisions that may be made for Prior Encumbered Obligations. The Master Resolution provides that the obligation of LCRA to pay or cause to be paid the amounts payable under the Master Resolution and any Supplement thereto is absolute, irrevocable, complete and unconditional, and the amount, manner and time of payment shall not be modified in any way regardless of any contingency. LCRA HAS NO TAXING POWER, AND NEITHER THE FULL FAITH AND CREDIT NOR THE TAXING POWER OF THE STATE OR ANY AGENCY OR POLITICAL SUBDIVISION THEREOF IS PLEDGED AS SECURITY FOR THE BONDS. THE OWNERS OF THE BONDS SHALL NEVER HAVE THE RIGHT TO DEMAND PAYMENT OF THE BONDS FROM ANY SOURCE OTHER THAN PLEDGED REVENUES. See "OVERVIEW OF LCRA OPERATIONS - Affiliates - *LCRA Transmission Services Corporation*," APPENDIX A - "SUMMARY OF CERTAIN PROVISIONS OF THE RESOLUTION" and APPENDIX C - "LCRA TRANSMISSION SERVICES CORPORATION - Initial Contractual Commitment."

Prior Encumbered Obligations. The Master Resolution permits LCRA to assume obligations ("Prior Encumbered Obligations") in connection with the acquisition of properties or assets that are secured by a lien on and pledge of that portion of the Pledged Revenues derived from such properties or assets which is superior to the lien established by the Master Resolution on behalf of Parity Debt.

The Twenty-Eighth Supplement

The issuance, sale and delivery of the Bonds is authorized by the Twenty-Eighth Supplement. The Twenty-Eighth Supplement includes the written determination of the LCRA Board, as required by the Master Resolution as a condition to the issuance of Parity Debt, that it will have sufficient funds to meet the financial obligations of LCRA, including the receipt of Pledged Revenues in amounts sufficient to satisfy the Annual Debt Service Requirements and to meet all other financial obligations of LCRA that are payable from Pledged Revenues after the issuance of the Bonds has been taken into account.

The Twenty-Eighth Supplement permits amendment, without the consent of the owners of the Bonds, for the same purposes for which amendment may be made to the Master Resolution without the consent of the Owners of Outstanding Parity Debt, including the Bonds. See APPENDIX A - "SUMMARY OF CERTAIN PROVISIONS OF THE RESOLUTION - Amendment and Waiver." The Twenty-Eighth Supplement also permits amendment, with the consent of the owners of a majority in aggregate principal amount of the Outstanding Bonds, other than amendments that (i) change the maturity of the Outstanding Bonds; (ii) reduce the rate of interest borne by the Outstanding Bonds; (iii) reduce the amount of principal payable on the Outstanding Bonds; (iv) modify the payment of principal of or interest on the Outstanding Bonds, or impose any conditions with respect to such payment; (v) affect the rights of the owners of less than all Bonds then Outstanding; or (vi) change the minimum percentage of Outstanding Principal Amount of Bonds necessary for consent to an amendment.

BOOK-ENTRY-ONLY SYSTEM

This section describes how ownership of the Bonds is to be transferred and how the principal of, premium, if any, and interest on the Bonds are to be paid to and credited by the Depository Trust Company ("DTC") while the Bonds are registered in its nominee's name. The information in this section concerning DTC and DTC's book-entry system has been provided by DTC for use in disclosure documents such as this Official Statement, but LCRA, its Financial Advisor and the Underwriters take no responsibility for the accuracy or completeness thereof.

LCRA cannot and does not give any assurance that (1) DTC will distribute payments of debt service on the Bonds, or redemption or other notices, to DTC Participant, (2) DTC Participants or others will distribute debt service payments paid to DTC or its nominee (as the registered owner of the Bonds), or redemption or other notices, to the Beneficial Owners, or that they will do so on a timely basis, or (3) DTC will serve and act in the manner described in this Official Statement. The current rules applicable to DTC are on file with the Securities and Exchange Commission, and the current procedures of DTC to be followed in dealing with DTC Participants are on file with DTC.

General

The Depository Trust Company ("DTC"), New York, New York, will act initially as securities depository for the Bonds. The Bonds will be issued as fully-registered securities registered in the name of Cede & Co. (DTC's partnership nominee) or such other name as may be requested by an authorized representative of DTC. One fully-registered certificate will be issued for each maturity of the Bonds in the aggregate principal amount of such maturity, and will be deposited with DTC.

DTC, the world's largest securities depository, is a limited-purpose trust company organized under the New York Banking Law, a "banking organization" within the meaning of the New York Banking Law, a member of the Federal Reserve System, a "clearing corporation" within the meaning of the New York Uniform Commercial Code, and a "clearing agency" registered pursuant to the provisions of Section 17A of the Securities Exchange Act of 1934. DTC holds and provides asset servicing for over 3.5 million issues of U.S. and non-U.S. equity issues, corporate and municipal debt issues, and money market instruments (from over 100 countries) that DTC's participants ("Direct Participants") deposit with DTC. DTC also facilitates the post-trade settlement among Direct Participants of sales and other securities transactions in deposited securities, through electronic computerized book-entry transfers and pledges between Direct Participants' accounts. This eliminates the need for physical movement of securities certificates. Direct Participants include both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, clearing corporations, and certain other organizations. DTC is a wholly-owned subsidiary of The Depository Trust & Clearing Corporation ("DTCC"). DTCC is the holding company for DTC, National Securities Clearing Corporation and Fixed Income Clearing Corporation, all of which are registered clearing agencies. DTCC is owned by the users of its regulated subsidiaries. Access to the DTC system is also available to others such as both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, and clearing corporations that clear through or maintain a custodial relationship with a Direct Participant, either directly or indirectly ("Indirect Participants"). DTC has Standard & Poor's highest rating: AAA. The DTC Rules applicable to its Participants are on file with the Securities and Exchange Commission. More information about DTC can be found at www.dtcc.com and www.dtc.org.

Purchases of Bonds under the DTC system must be made by or through Direct Participants, which will receive a credit for the Bonds on DTC's records. The ownership interest of each actual purchaser of each Bond ("Beneficial Owner") is in turn to be recorded on the Direct and Indirect Participants' records. Beneficial Owners will not receive written confirmation from DTC of their purchase.

Beneficial Owners are, however, expected to receive written confirmations providing details of the transaction, as well as periodic statements of their holdings, from the Direct or Indirect Participant through which the Beneficial Owner entered into the transaction.

Transfers of ownership interests in the Bonds are to be accomplished by entries made on the books of Direct and Indirect Participants acting on behalf of Beneficial Owners. Beneficial Owners will not receive certificates representing their ownership interests in the Bonds, except in the event that use of the book-entry system for the Bonds is discontinued.

To facilitate subsequent transfers, all Bonds deposited by Direct Participants with DTC are registered in the name of DTC's partnership nominee, Cede & Co., or such other name as may be requested by an authorized representative of DTC. The deposit of Bonds with DTC and their registration in the name of

Cede & Co., or such other DTC nominee, do not effect any change in beneficial ownership. DTC has no knowledge of the actual Beneficial Owners of the Bonds; DTC's records reflect only the identity of the Direct Participants to whose accounts such Bonds are credited, which may or may not be the Beneficial Owners. The Direct and Indirect Participants will remain responsible for keeping account of their holdings on behalf of their customers.

Conveyance of notices and other communications by DTC to Direct Participants, by Direct Participants to Indirect Participants, and by Direct Participants and Indirect Participants to Beneficial Owners will be governed by arrangements among them, subject to any statutory or regulatory requirements as may be in effect from time to time. Beneficial Owners of Bonds may wish to take certain steps to augment the transmission to them of notices of significant events with respect to the Bonds, such as redemptions, tenders, defaults, and proposed amendments to the Bond documents. For example, Beneficial Owners of Bonds may wish to ascertain that the nominee holding the Bonds for their benefit has agreed to obtain and transmit notices to Beneficial Owners. In the alternative, Beneficial Owners may wish to provide their names and addresses to the Paying Agent/Registrar and request that copies of notices be provided directly to them.

Redemption notices shall be sent to DTC. If less than all of the Bonds within a maturity are being redeemed, DTC's practice is to determine by lot the amount of the interest of each Direct Participant in such maturity to be redeemed.

Neither DTC nor Cede & Co. (nor any other DTC nominee) will consent or vote with respect to the Bonds unless authorized by a Direct Participant in accordance with DTC's Procedures. Under its usual procedures, DTC mails an Omnibus Proxy to LCRA as soon as possible after the record date. The Omnibus Proxy assigns Cede & Co.'s consenting or voting rights to those Direct Participants to whose accounts Bonds are credited on the record date (identified in a listing attached to the Omnibus Proxy).

Principal, premium, if any, and interest payments on the Bonds will be made to Cede & Co., or such other nominee as may be requested by an authorized representative of DTC. DTC's practice is to credit Direct Participants' accounts upon DTC's receipt of funds and corresponding detail information from LCRA or the Paying Agent/Registrar, on payable date in accordance with their respective holdings shown on DTC's records. Payments by Participants to Beneficial Owners will be governed by standing instructions and customary practices, as is the case with securities held for the accounts of customers in bearer form or registered in "street name," and will be the responsibility of such Participant and not of DTC nor its nominee, the Paying Agent/Registrar, or LCRA, subject to any statutory or regulatory requirements as may be in effect from time to time. Payment of principal, premium, if any, and interest payments to Cede & Co. (or such other nominee as may be requested by an authorized representative of DTC) is the responsibility of LCRA or the Paying Agent/Registrar, disbursement of such payments to Direct Participants will be the responsibility of DTC, and disbursement of such payments to the Beneficial Owners will be the responsibility of Direct and Indirect Participants.

DTC may discontinue providing its services as depository with respect to the Bonds at any time by giving reasonable notice to LCRA. Under such circumstances, in the event that a successor depository is not obtained, certificates for the Bonds are required to be printed and delivered.

LCRA may decide to discontinue use of the system of book-entry-only transfers through DTC (or a successor securities depository). In that event, certificates for the Bonds will be printed and delivered.

The Paying Agent/Registrar and LCRA, as long as the DTC book-entry system is used for the Bonds, will send any notice of redemption, notice of proposed amendment to the Resolution, or other notices with respect to such Bonds only to DTC. Any failure by DTC to advise any DTC Participant, or of any Direct Participant or Indirect Participant to notify the Beneficial Owners, of any notices and their contents or effect will not affect the validity of the redemption of the Bonds called for redemption or of any other action premised on any such notice. Redemption of portions of the Bonds by LCRA will reduce the

outstanding principal amount of such Bonds held by DTC. In such event, DTC may implement, through its book-entry system, a redemption of such Bonds held for the account of DTC Participants in accordance with its own rules or other agreements with DTC Participants and then Direct Participants and Indirect Participants may implement a redemption of such Bonds from the Beneficial Owners. Any such selection of the Bonds to be redeemed will not be governed by the Resolution and will not be conducted by LCRA or the Paying Agent/Registrar. Neither LCRA nor the Paying Agent/Registrar will have any responsibility or obligation to Direct Participants, Indirect Participants, or the persons for whom DTC Participants act as nominees, with respect to the payments on the Bonds or the providing of notice to Direct Participants, Indirect Participants, or Beneficial Owners of the selection of portions of the Bonds for redemption.

The information in this section concerning DTC and DTC's book-entry system has been obtained from sources that LCRA, its Financial Advisor and the Underwriters believe to be reliable, but LCRA, its Financial Advisor and the Underwriters take no responsibility for the accuracy thereof.

Effect of Termination of Book-Entry-Only System

In the event the book-entry-only system is discontinued, the persons to whom Bond certificates are delivered will be treated as Owners for all purposes of the Resolution, including the giving to LCRA or the Paying Agent/Registrar of any notice, consent, request or demand pursuant to the Resolution for any purpose whatsoever. In such event, the Bonds will be transferable to such Owners and interest on the Bonds will be payable by check of the Paying Agent mailed to such Owners.

Responsibilities with Respect to the Book-Entry-Only System

The Resolution provides that with respect to the Bonds registered in the name of Cede & Co., as nominee of DTC, LCRA and the Paying Agent/Registrar shall have no responsibility or obligation to any DTC Participant or to any person on behalf of whom a DTC Participant holds an interest in the Bonds. Without limiting the preceding sentence, the Resolution provides that neither LCRA nor the Paying Agent/Registrar shall have any responsibility or obligation with respect to (i) the accuracy of the records of DTC, Cede & Co., or any DTC Participant with respect to any ownership interest in the Bonds, (ii) the delivery to any DTC Participant or any other person, other than an Owner, as shown on the Security Register, of any notice with respect to the Bonds, including any notice of redemption, or (iii) the payment to any DTC Participant or any other person, other than an Owner, as shown on the Security Register, of any amount with respect to principal of, or premium, if any, or interest on the Bonds.

In reading this Official Statement, it should be understood that while the Bonds are in the book-entry-only system, references in other sections of this Official Statement to Owners should be read to include the person for whom a Direct or Indirect Participant acquires an interest in the Bonds, but (i) all rights of ownership must be exercised through DTC and the book-entry-only system, and (ii) except as described above, notices that are to be given to Owners under the Resolution will be given only to DTC.

DESCRIPTION OF THE REVENUE FINANCING PROGRAM

On September 22, 1999, the LCRA Board adopted the "Master Resolution Establishing the Lower Colorado River Authority Revenue Financing Program." The LCRA Board adopted the Master Resolution and established the Revenue Financing Program to enable LCRA to most effectively respond to the changing market conditions in the electric industry, to enhance its competitive ability and to provide it with increased financial flexibility. Under the Master Resolution, LCRA can issue and enter into obligations, including bonds and other types of obligations, secured by and payable from a lien on and pledge of the Pledged Revenues. Parity Debt is issued by the adoption by the LCRA Board of Supplements to the Master Resolution. Each Supplement shall provide for the authorization, sale, delivery, characteristics, provisions of payment and redemption, and security of each issue or series of Parity Debt and any other matters related to Parity Debt that are consistent with the Constitution and laws of the State or the provisions of the Master Resolution.

Pledge of LCRA Revenues

The Resolution establishes a gross pledge of LCRA's revenues through the pledge of Pledged Revenues, which are defined to include all lawfully available funds of LCRA, including all amounts received pursuant to Contractual Commitments (including the Initial Contractual Commitment) and all other revenues received or derived by LCRA, and all fund balances attributable to such income. The Resolution excludes certain funds of LCRA from Pledged Revenues, including but not limited to, customer's deposits, contributions in aid of construction, investment earnings to the extent that LCRA is required to rebate such earnings to the United States of America, any moneys obtained pursuant to drawings on a letter of credit, line of credit, bond insurance policy or similar financial arrangements that secure the payment of any Debt, proceeds obtained pursuant to the remarketing of any Debt of LCRA and income derived from the operation or ownership of Separate System Projects or projects financed with the proceeds of Contract Revenue Bonds. See APPENDIX A - "SUMMARY OF CERTAIN PROVISIONS OF THE RESOLUTION - Definitions."

The Bonds, and all other Parity Debt, are secured by and payable from a lien on and pledge of the Pledged Revenues. The Pledged Revenues are further pledged to the establishment and maintenance of any funds that may be provided to secure the repayment of Parity Debt in accordance with the Master Resolution and any Supplement. Parity Debt, including the Bonds, is not secured by or payable from a mortgage or deed of trust on any properties, whether real, personal, or mixed, of LCRA or any Affiliate other than the Pledged Revenues. No payment funds, debt service reserve funds or other funds are being established to secure the payment of the Bonds.

Under State law and pursuant to the Master Resolution, LCRA is authorized to create and utilize Affiliates and Obligated Affiliates and to enter into Contractual Commitments to directly implement business activities of LCRA where legal or business reasons exist for such activities to be performed by an Affiliate. Revenues received by LCRA pursuant to a Contractual Commitment entered into with an Obligated Affiliate constitute Pledged Revenues. Additionally, revenues of any Obligated Affiliate are subject to a lien for the benefit of LCRA but not Bondowners. Revenues of Affiliates that are not a party to a Contractual Commitment do not constitute Pledged Revenues. LCRA has created TSCorp as an Affiliate and entered into the Initial Contractual Commitment, the payments under which constitute Pledged Revenues. As a result of the Initial Contractual Commitment, TSCorp is an Obligated Affiliate of LCRA pursuant to the Master Resolution. See "OVERVIEW OF LCRA OPERATIONS - Affiliates - *LCRA Transmission Services Corporation*," "WHOLESALE POWER SERVICES - GenTex," and APPENDIX C - "LCRA TRANSMISSION SERVICES CORPORATION - Initial Contractual Commitment."

LCRA has liens on all revenues of TSCorp and a first lien security interest on all of the assets of TSCorp. This security interest in and mortgage on the assets of TSCorp and the liens on TSCorp's revenues, however, does not directly secure the Bonds or the Bondowners and the Bondowners may not compel LCRA to exercise any rights under such liens and security interests.

Rate Covenant

The Pledged Revenues are to be derived from the revenues of LCRA, including the rates and charges for the delivery of its services pursuant to the statutory rate covenant set forth in Section 8503.011, Texas Special District Local Laws Code, as amended (the "Statutory Rate Covenant"), and amounts to be derived from Contractual Commitments. Pursuant to the Statutory Rate Covenant, LCRA is obligated to at all times maintain rates, fees, or charges for the sale or use of the output of, or goods or services provided by LCRA, which, together with other Pledged Revenues (excluding the proceeds from the sale of any properties or assets of LCRA used in carrying out its operations which were sold solely for the purpose of meeting the requirements of such rate covenant) and the anticipated receipt of proceeds of sale of any Debt of LCRA that will be used to pay the debt service of any Debt of LCRA issued in anticipation of such receipt, will be sufficient to: (i) pay all Operating and Maintenance Expenses; (ii) pay the Annual Debt Service Requirements and debt service on all Subordinate Lien Obligations then Outstanding as it becomes due for payment; (iii) maintain any reserve or reserves, or special fund or funds, if any, established by

LCRA pursuant to any Supplement or resolution authorizing the issuance of Subordinate Lien Obligations, in such amounts as may be determined from time to time by LCRA; and (iv) pay any and every other indebtedness, liability, or obligation of LCRA reasonably expected to be payable from Pledged Revenues for the payment of money, however entered into or incurred, and whether arising from contract, implied contract or otherwise, including, without limitation, any other indebtedness, liability, or obligation arising out of a monetary judgment or equitable order entered against LCRA by a court of competent jurisdiction which has become final and nonappealable.

For the purposes of the foregoing Statutory Rate Covenant, Operation and Maintenance Expenses and Debt to which Annual Debt Service Requirements apply exclude costs and expenses and Debt of entities whose financial statements are required by Accounting Principles to be consolidated with those of LCRA, including any debt issued by, or Contract Revenue Bonds issued on behalf of, TSCorp.

A substantial portion of LCRA's total revenues is derived from the sale of wholesale electricity to its wholesale customers pursuant to Wholesale Power Agreements (as defined under "WHOLESALE POWER SERVICES – Wholesale Power Agreements - *General*"). The Wholesale Power Agreements are not pledged as security for Parity Debt. There are no covenants in the Resolution pertaining to the Wholesale Power Agreements or limitations on LCRA's ability to amend the Wholesale Power Agreements. See "WHOLESALE POWER SERVICES – Wholesale Power Agreements." While LCRA has negotiated the Amended and Restated Agreements (as defined under "WHOLESALE POWER SERVICES – Wholesale Power Agreements - *General*") and may negotiate further amendments that have or may result in LCRA's wholesale electric customers having the ability to take more of their respective requirements from other suppliers as well as other potential changes, it is LCRA's intention that any such Amended and Restated Agreements will still allow LCRA to satisfy its obligations to provide electricity to its wholesale electric customers and its obligations under the Resolution with respect to Parity Debt, including the Bonds. See "WHOLESALE POWER SERVICES – Wholesale Power Agreements - *Amendment of Wholesale Power Agreements*" and "FACTORS TO BE CONSIDERED IN INVESTING IN THE BONDS - Wholesale Power Agreements and Future Capital Improvements."

General Covenants

The Master Resolution also contains the general covenants of LCRA with respect to the timely payment of debt service on Parity Debt and all other obligations of LCRA and the performance of all covenants contained in the Master Resolution and in each Supplement. In the Master Resolution, LCRA represents that it lawfully owns or has the right to use the properties and facilities used in its operations and that it will defend that title and right. In addition, LCRA covenants that it will not, except as permitted by the Master Resolution, grant a security interest in the Pledged Revenues that will be superior to the lien that secures the payment of Parity Debt and covenants to defend and protect the lien on the Pledged Revenues. See "THE BONDS - Security for the Bonds - *Prior Encumbered Obligations*."

LCRA has agreed in the Master Resolution to maintain its properties in working order and condition and to make all necessary repairs, replacements, extensions and betterments necessary for the proper operation of LCRA's facilities. Pursuant to the terms of the Master Resolution, LCRA is not, however, obligated to maintain or keep any of its properties, if, in the reasonable judgment of the LCRA Board, it would not be economical to do so. See "DESCRIPTION OF THE REVENUE FINANCING PROGRAM - Disposition of Assets." LCRA has further agreed to maintain insurance, including a self insurance program, on its properties to the extent that similar insurance is usually carried by public or governmental authorities operating like properties.

Outstanding and Additional Debt

Outstanding Debt. As of November 1, 2008, LCRA had bonded indebtedness constituting Parity Debt outstanding in an amount of \$1,573,915,000, excluding commercial paper, contract obligations to the Texas Water Development Board relating to the City of Leander, Texas and relating to Brushy Creek

Regional Wastewater System and guarantee obligations of LCRA with respect to certain obligations of TSCorp, all as discussed below.

As of November 1, 2008, LCRA had approximately \$251.5 million of its Outstanding Parity Debt allocated to TSCorp under the Initial Contractual Commitment. See APPENDIX C - "LCRA TRANSMISSION SERVICES CORPORATION - Capital Charge Requirements" for a schedule of TSCorp's annual payments to LCRA under the Initial Contractual Commitment.

LCRA has established a Tax-Exempt Commercial Paper program authorized in an amount not to exceed \$350 million and a Taxable Commercial Paper program authorized in an amount not to exceed \$350 million which are intended to be used to finance a portion of LCRA's ongoing capital expenditures. The commercial paper notes under each program are issued as Parity Debt and may not be issued in an amount that exceeds the amounts supported by their respective liquidity facilities. Liquidity for the Tax-Exempt Commercial Paper program is provided by a liquidity provider pursuant to a tax-exempt credit agreement. Under such tax-exempt credit agreement, the liquidity provider therein is obligated to lend LCRA an aggregate amount not to exceed \$287.5 million for the purpose of paying the principal and interest due on notes issued under the Tax-Exempt Commercial Paper program. A \$37.5 million component of the loan commitment expires October 13, 2011, a \$175 million component of the loan commitment expires June 26, 2009, and the remaining \$75 million component of the loan commitment expires October 13, 2010. Each such component of the loan commitment may be renewed for additional periods upon the request of LCRA and the approval of the liquidity provider. Liquidity for the Taxable Commercial Paper program is provided by certain liquidity providers pursuant to a taxable credit agreement. Under the taxable credit agreement, liquidity providers therein are obligated to lend LCRA an aggregate amount not to exceed \$40 million for the purpose of paying the principal and interest due on notes issued under the Taxable Commercial Paper program. The taxable credit agreement expires on November 1, 2011. However, the commitment may be renewed for additional periods of one or more years upon the request of LCRA and the approval of each of the liquidity providers.

A portion of the outstanding Tax-Exempt Commercial Paper notes described above are being refunded by the Bonds. See "PURPOSE OF FINANCING - Purpose of the Bonds." After the delivery of the Bonds, approximately \$73.7 million of Tax-Exempt Commercial Paper notes will remain outstanding.

LCRA also entered into a contract with the Texas Water Development Board (the "TWDB") with respect to LCRA's repurchase obligation of certain water supply facilities related to the City of Leander, Texas water supply system purchased by the TWDB. The contract, in which LCRA's payment obligations aggregate \$10.5 million plus interest amortized over a 13 year period following a 20 year period of payments of interest only, constitutes Parity Debt. Additionally, LCRA and the TWDB entered into a contract whereby LCRA has the obligation to repurchase certain wastewater facilities relating to LCRA's Brushy Creek Regional Wastewater System purchased by the TWDB. LCRA's payment obligation under this contract is \$14,040,000 amortized over a 13 year period following a 20 year period of payments of interest only. This contract constitutes Parity Debt of LCRA. See "WATER SERVICES - Regional and Municipal Water and Wastewater Utility Services and Systems."

Under State law, LCRA is permitted to guarantee, or otherwise provide credit support to, obligations and contracts of its Affiliates. The Master Resolution also authorizes such guarantees with Affiliates. In connection with the LCRA-TSCorp asset transfer, LCRA entered into a Guarantee Agreement, dated as of October 1, 2001, with American Electric Power Service Company ("AEP") (the "LCRA JDA Guarantee"), whereby LCRA unconditionally guaranteed TSCorp's performance and payment obligations under the Joint Development Agreement, effective July 14, 2001 and amended in September 2003, between AEP and TSCorp (the "JDA"). LCRA's payment obligations, if any, under the LCRA JDA Guarantee constitute Parity Debt of LCRA. Additionally, to the extent LCRA makes any payments under the LCRA JDA Guarantee, TSCorp is obligated under the Initial Contractual Commitment to repay LCRA within a 24 month period. The maximum projected total remaining capital cost of all "in-scope" projects under the JDA for which TSCorp is responsible is approximately \$8.6 million for the Fiscal Year 2009 through Fiscal Year 2013 period. Additionally, the JDA provides for liquidated damages of \$7.5 million

as a result of terminations for cause by either party. LCRA's management does not believe LCRA will ever be required to perform under the LCRA JDA Guarantee. The JDA provides for termination of the agreement with six months notice, except for certain projects already determined to be "in-scope" at the time of such notice. LCRA has not reserved any amounts against the potential liability of the LCRA JDA Guarantee. Additionally, LCRA has the ability to guarantee or otherwise provide credit support to any obligation or contract of any Affiliate, including TSCorp. See APPENDIX C - "LCRA TRANSMISSION SERVICES CORPORATION - TSCorp Facilities and Assets and Planned Acquisitions/Expansions" and "- Initial Contractual Commitment."

There are presently no outstanding Prior Encumbered Obligations, separate system debt or debt subordinate to the Outstanding Parity Debt. LCRA has seven currently outstanding series of contact revenue bonds which it has issued on behalf of TSCorp with an aggregate principal amount of \$1,018,675,000 and its Transmission Contract Revenue Commercial Paper Notes (LCRA Transmission Services Corporation Project), Tax-Exempt Series and Transmission Contract Revenue Commercial Paper Notes (LCRA Transmission Services Corporation Project), Tax-Exempt Series B authorized in the aggregate maximum amount of \$250 million of principal and interest, all of which constitute Contract Revenue Bonds under the Master Resolution but do not constitute Parity Debt and which are payable from revenues of TSCorp and subordinate to TSCorp's payment obligations under the Initial Contractual Commitment. As of November 15, 2008, the total amount of such transmission contract revenue commercial paper notes outstanding was \$82 million.

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Outstanding Parity Debt of LCRA as of Anticipated Closing on the Bonds⁽¹⁾

<u>Issue Title</u>	<u>Outstanding Amount</u>
Refunding Revenue Bonds, Series 1999A	\$ 346,915,000
Refunding Revenue Bonds, Series 1999B	256,235,000
Refunding Revenue Bonds, Series 1999E	18,710,000
Refunding Revenue Bonds, Series 1999F	86,385,000
Refunding Revenue Bonds, Series 1999G	30,880,000
Refunding Revenue Bonds, Series 1999H	1,660,000
Refunding Revenue Bonds, Series 1999I	3,155,000
Refunding and Improvement Revenue Bonds, Series 2001	93,670,000
Refunding and Improvement Revenue Bonds, Series 2001A	131,630,000
Refunding Revenue Bonds, Series 2002	112,305,000
Refunding and Improvement Revenue Bonds, Series 2003	77,750,000
Refunding Revenue Bonds, Series 2004	94,400,000
Refunding Revenue Bonds, Series 2004D	47,240,000
Refunding Revenue Bonds, Series 2006	77,020,000
Refunding Revenue Bonds, Series 2008	195,960,000
Refunding Revenue Bonds, Series 2008A	209,645,000 ⁽²⁾
Commercial Paper Notes, Taxable Series A ⁽³⁾	22,400,000
Commercial Paper Notes, Tax-Exempt Series A ⁽³⁾	<u>73,700,000</u> ⁽⁴⁾
	<u>\$ 1,879,660,000</u> ⁽²⁾
Total	

⁽¹⁾ Does not include LCRA's payment obligations under (i) its contract with the TWDB for water supply facilities for the City of Leander, Texas, (ii) its contract with the TWDB for wastewater facilities of the Brushy Creek Regional Wastewater System or (iii) the LCRA JDA Guarantee. Reflects the maturity amounts of certain capital appreciation bonds.

⁽²⁾ Includes the Bonds in the process of issuance.

⁽³⁾ Authorized in an amount up to \$350,000,000.

⁽⁴⁾ Excludes the Refunded Obligations being refunded by the Bonds.

Additional Debt. In the Master Resolution, LCRA reserved the right and power to issue or incur Parity Debt for any purpose authorized by law pursuant to the provisions of the Master Resolution and a Supplement. LCRA may incur, assume, guarantee, or otherwise become liable with respect to any Parity Debt if the LCRA Board finds that it will have sufficient funds to meet the financial obligations of LCRA, including the receipt of Pledged Revenues in amounts sufficient to satisfy the Annual Debt Service Requirements and to meet all other financial obligations of LCRA payable from the Pledged Revenues. LCRA may not issue or incur Parity Debt unless an Authorized Representative of LCRA delivers a certificate to the LCRA Board stating either (i) that, to the best of his or her knowledge, LCRA has not failed to comply with the covenants contained in the Master Resolution and any Supplement to any material extent and is not in default in any material extent, in the performance and observance of any of the terms, provisions and conditions thereof, or (ii) that after the issuance of such Parity Debt to cure an existing default, LCRA will not be in default, to any material extent, in the performance or observance of any of the terms, provisions and conditions of the Master Resolution or any Supplement.

LCRA may establish a payment fund, a reserve fund and/or any other fund or funds pursuant to the provisions of a Supplement for the purpose of paying or securing a particular issue or series of Parity Debt or any specific group of issues or series of Parity Debt and the amounts once deposited in said funds shall no longer constitute Pledged Revenues but shall be held solely for the benefit of the Owners of the particular Parity Debt for which such fund was established. Prior to establishing any such fund, an Authorized Representative must provide a certification to the LCRA Board to the effect that the establishment and operation of such fund will not have a material adverse effect on the ability of LCRA to comply with its covenants in the Resolution or in any Supplements authorizing the issuance of Outstanding Parity Debt.

No payment or reserve funds have been established in connection with the issuance of the Outstanding Parity Debt, except that note payment funds have been established with the issuing and paying agent for the Tax-Exempt Commercial Paper and Taxable Commercial Paper programs. LCRA will not establish any payment or reserve funds in connection with the Bonds.

In addition, LCRA has the ability to issue a variety of other obligations, including, but not limited to, Separate System Obligations, Contract Revenue Bonds and Subordinate Lien Obligations, and may issue such obligations jointly with, or guarantee the debt of, Affiliates. See "DESCRIPTION OF THE REVENUE FINANCING PROGRAM - Outstanding and Additional Debt - *Outstanding Debt*," "LCRA FINANCIAL POLICIES, BUSINESS PLAN AND CAPITAL BUDGET - Capital Improvements and Incurrence of Additional Indebtedness" and APPENDIX A - "SUMMARY OF CERTAIN PROVISIONS OF THE RESOLUTION."

Dealings with Affiliates

In the Master Resolution, the LCRA Board covenants to exercise control over the operations of each Affiliate to ensure that each Affiliate operates in a manner that, in the sole judgment of the LCRA Board, does not have a material adverse effect on the operations of LCRA or its ability to comply with its obligations under the Master Resolution and the Supplements. Specifically, the LCRA Board covenants to retain the right to approve any debt to be incurred by an Affiliate and agrees to not approve the issuance or incurrence of the debt if, in the judgment of the LCRA Board, the satisfaction of the obligations relating to the debt will materially adversely affect the ability of the Affiliate to comply with the provisions of its Contractual Commitments, if such Affiliate is an Obligated Affiliate, or its other legal obligations. Further, and to the extent permitted by law, the LCRA Board covenants to retain the right to (i) approve the budget of each Affiliate; (ii) appoint and remove the members of the board of directors of each Affiliate; (iii) approve the articles of incorporation and the by-laws, and any amendments thereto, of each Affiliate; (iv) approve the disposition of all or substantially all of the assets of an Affiliate; and (v) to require that each Affiliate's fiscal year be the same as LCRA's Fiscal Year.

In addition, prior to LCRA issuing any Debt payable from Pledged Revenues on behalf of an Obligated Affiliate or prior to guaranteeing the obligations of an Affiliate, causing such affiliate to become an Obligated Affiliate, (i) the LCRA Board and such Affiliate must enter into a Contractual Commitment obligating the Affiliate to make payments to LCRA in amounts and at the times necessary to allow LCRA to pay the Annual Debt Service Requirements, if any, relating to such Debt or to pay amounts, including interest thereon, advanced by LCRA pursuant to the guarantee and to pay all expenses and costs of LCRA, including overhead, related to the activities of LCRA under the Contractual Commitment, and (ii) the LCRA Board shall find that the financial projections of the Affiliate provide a reasonable basis for determining that the Affiliate will have the financial ability to meet its obligations with respect to the Contractual Commitment.

"Contractual Commitment" means a written agreement pursuant to which an Obligated Affiliate agrees: (i) to observe and perform the obligations that LCRA has covenanted to cause Affiliates to observe and perform under the Master Resolution and any Supplement; (ii) to pay or otherwise transfer to LCRA such amounts as are required by the provisions described under either this subsection or the subsection "Disposition of Assets" below, and to grant to LCRA a first lien on, pledge of, and perfected security interest in the properties and assets transferred to an Obligated Affiliate by LCRA (the "Transferred Assets") and in all of the revenues of the Obligated Affiliate to secure the obligation to make such payment; (iii) subject to any applicable legal restrictions relating to the disposition of assets by organizations described in Section 501(c)(3) of the Code, that upon liquidation or dissolution of such

Obligated Affiliate all or a portion of the remaining assets of such Obligated Affiliate shall be transferred to LCRA in accordance with the organizational documents of such Obligated Affiliate; (iv) to comply with covenants to be contained in the Contractual Commitment relating to its operations, assets, revenues and obligations to LCRA which are substantially in the form of the covenants of LCRA contained in the Master Resolution; and (v) to prohibit the creation of any obligation payable from a lien on, pledge of, or security interest in the Transferred Assets or the revenues of the Obligated Affiliate on parity with or superior to the lien, pledge, and security interest created for the benefit of LCRA in the Contractual Commitment.

LCRA created TSCorp as an Affiliate and entered into the Initial Contractual Commitment. The Initial Contractual Commitment constitutes a Contractual Commitment under the Master Resolution. As a result of the Initial Contractual Commitment, TSCorp is an Obligated Affiliate of LCRA pursuant to the Master Resolution. See "OVERVIEW OF LCRA OPERATIONS - Affiliates - *LCRA Transmission Services Corporation*" and APPENDIX C - "LCRA TRANSMISSION SERVICES CORPORATION."

Additionally, LCRA also created GenTex and LCRA Energy as Affiliates as discussed in more detail in "WHOLESALE POWER SERVICES - GenTex" and "- LCRA Wholesale Energy Services Corporation." Neither GenTex nor LCRA Energy is an Obligated Affiliate under the Master Resolution at the present time, and LCRA does not contemplate that such Affiliates will become Obligated Affiliates.

LCRA reserves the right to enter into or undertake any activity with, for, or on behalf of, an Affiliate, to the extent authorized by law, including guaranteeing obligations of the Affiliates, incurring liabilities on behalf of the Affiliates, issuing Debt for the benefit of Affiliates and entering into agreements or undertaking any other lawful act or activity with respect to an Affiliate. LCRA entered into the LCRA JDA Guarantee with AEP whereby LCRA will unconditionally guarantee TSCorp's performance and payment obligations under the JDA. See "DESCRIPTION OF THE REVENUE FINANCING PROGRAM - Outstanding and Additional Debt - *Outstanding Debt*," and APPENDIX C - "LCRA TRANSMISSION SERVICES CORPORATION."

Disposition of Assets

To the extent provided by law, the Master Resolution permits LCRA to convey, sell, or otherwise dispose of any of its properties or other assets provided that prior to such disposition (i) the LCRA Board finds that after the conveyance, sale, or other disposition of such properties or assets, Pledged Revenues anticipated to be received in each Fiscal Year that Parity Debt is scheduled to be outstanding will be sufficient to satisfy the Annual Debt Service Requirements and to meet all other financial obligations of LCRA that are payable from Pledged Revenues and (ii) if the transfer is of all or a material portion of its electric generation or transmission, water, or wastewater properties or assets and is to any person other than to an Affiliate, LCRA receives confirmation from each nationally recognized credit rating agency then maintaining a rating with respect to the Outstanding Parity Debt that such transfer, in and of itself, will not cause the then current rating to be lowered or withdrawn. LCRA need not comply with the requirement of subparagraph (ii) above, however, if a majority of the Outstanding Principal Amount of the Parity Debt is insured by one or more municipal bond insurance policies and each respective bond insurer consents to the transfer.

In addition, prior to the transfer by LCRA of all or a material portion of its electric generation or transmission, water or wastewater properties or assets to an Affiliate, (i) the LCRA Board and the Affiliate must enter into a Contractual Commitment obligating the Affiliate to make payments to LCRA in amounts and at the times necessary to allow LCRA to pay the Annual Debt Service Requirements allocated to the respective Transferred Assets as reflected on the books and records of LCRA and to pay all expenses and costs of LCRA, including overhead, related to the activities of LCRA under the Contractual Commitment, (ii) the LCRA Board must find that the financial projections of the Affiliate provide a reasonable basis for determining that the Affiliate will have the financial ability to meet its obligations with respect to the Contractual Commitment and (iii) the LCRA Board shall have received an opinion of Bond Counsel, subject to customary limitations, to the effect that the Contractual Commitment constitutes the legal, valid, and enforceable obligation of the Affiliate. LCRA has further covenanted that it will not grant a security interest in the Contractual Commitment for the benefit of any other person.

LCRA Financing Program Special-Purpose Financial Statements

Generally accepted accounting principles require that the financial statements of LCRA and its Affiliates be presented on a consolidated basis. Revenues, operation and maintenance expenses and fund balances of Affiliates do not constitute Pledged Revenues, Operation and Maintenance Expenses or fund balances of LCRA. Amounts received from Obligated Affiliates pursuant to Contractual Commitments constitute Pledged Revenues. Accordingly, LCRA is required to cause to be prepared each Fiscal Year a special-purpose combined financial statement ("LCRA Financing Program Special-Purpose Financial Statements") reflecting only the operations of LCRA and all Obligated Affiliates for such Fiscal Year. The LCRA Financing Program Special-Purpose Financial Statements for each Fiscal Year must be certified by a Certified Public Accountant and contain an audited combined balance sheet as of the end of such Fiscal Year, an audited combined statement of operations for such Fiscal Year, and an audited combined statement of cash flows for such Fiscal Year showing in each case in comparative form the financial figures for the preceding year. See "SELECTED FINANCIAL AND OPERATING INFORMATION - Selected Financial Information."

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DEBT SERVICE REQUIREMENTS

The table below illustrates the debt service requirements for the Outstanding Parity Debt and the Bonds.

Fiscal Year Ending June 30,	Debt Service	Debt Service		Total Debt
	Requirements	Requirements		Service
	of the Outstanding Parity Debt ⁽¹⁾	of the Bonds ⁽²⁾		Requirements ⁽¹⁾⁽²⁾
		Principal ⁽²⁾	Interest	
2009	\$ 130,004,145	\$ 1,920,000	\$ 5,197,578	\$ 137,121,723
2010	174,117,926	4,780,000	12,651,963	191,549,889
2011	175,229,613	3,550,000	12,460,763	191,240,375
2012	175,017,363	2,600,000	12,283,263	189,900,625
2013	175,675,414	300,000	12,153,263	188,128,676
2014	176,488,817	5,005,000	12,138,263	193,632,079
2015	176,864,915	6,300,000	11,888,013	195,052,928
2016	175,007,262	6,200,000	11,573,013	192,780,274
2017	116,439,096	500,000	11,263,013	128,202,108
2018	105,573,372	8,305,000	11,238,013	125,116,384
2019	120,308,583	8,200,000	10,822,763	139,331,616
2020	115,349,612	7,735,000	10,371,763	133,456,374
2021	98,678,173	-	9,927,000	108,605,173
2022	69,927,298	7,400,000	9,927,000	87,254,298
2023	71,243,032	7,825,000	9,501,500	88,569,532
2024	63,495,901	5,740,000	9,051,563	78,287,463
2025	59,856,532	6,100,000	8,692,813	74,649,344
2026	51,225,690	6,480,000	8,311,563	66,017,252
2027	47,868,098	6,885,000	7,906,563	62,659,661
2028	47,351,380	7,320,000	7,476,250	62,147,630
2029	51,349,079	13,315,000	7,018,750	71,682,829
2030	47,117,642	14,150,000	6,186,563	67,454,204
2031	46,317,784	15,035,000	5,302,188	66,654,971
2032	31,729,397	8,990,000	4,632,500	45,081,897
2033	27,050,911	9,605,000	3,750,025	40,405,936
2034	21,828,297	10,255,000	3,095,513	35,178,809
2035	17,871,980	10,950,000	2,396,575	31,218,555
2036	17,867,942	11,705,000	1,650,138	31,223,079
2037	14,186,258	12,495,000	852,075	27,533,333
2038	<u>666,729</u>	<u>-</u>	<u>-</u>	<u>666,729</u>
TOTALS	\$2,601,708,504	\$209,645,000	\$239,450,241	\$3,050,803,745

⁽¹⁾ Excludes the Refunded Obligations, the obligation of LCRA under the LCRA JDA Guarantee and the "undelivered" portion of LCRA's payment obligations under the contract with the TWDB regarding the Brushy Creek Regional Wastewater System. The debt service requirements also include \$73.7 million of tax exempt commercial paper notes bearing interest at an assumed rate of 3.5% and \$22.4 million of taxable commercial paper notes bearing interest at an assumed rate of 5%. All commercial paper is amortized assuming level debt service payments through an assumed maturity date of May 15, 2021. In addition, the debt service requirements include payment obligations of LCRA under its contract with the TWDB relating to water supply facilities for the City of Leander and the "delivered" portion of LCRA's payment obligations under the contract with the TWDB regarding the Brushy Creek Regional Wastewater System. Reflects mandatory sinking fund redemption of certain term bonds.

⁽²⁾ Reflects mandatory sinking fund redemptions of term bonds in 2023, 2028, 2031 and 2037.

LCRA FINANCIAL POLICIES, BUSINESS PLAN AND CAPITAL BUDGET

Financial Policies and Business Plan

General. The LCRA Board has adopted policies covering financial management, business planning, insurance, risk management, investment and other policy matters (the "Policies"). The Policies, subject to periodic review and revision, are not incorporated into the Resolution and do not represent an agreement or covenant for the benefit of the Owners of LCRA Debt, including the Bonds. The LCRA Board may amend or modify the Policies from time to time without notice. The Policies represent general financial and business strategies that are implemented through and in accordance with LCRA's five-year plan for financial and business operations (the "Business Plan"), which is revised annually.

Set forth below is a description of the significant Policies of LCRA.

Debt. The Policies provide that LCRA will use a combination of internally generated funds or "equity" and debt to finance capital projects and that LCRA may structure the debt issues to approximate the average life of the assets financed. However, the Policies provide that debt issues may be structured with a shorter average maturity if economically justified. The Policies limit the maximum amount of variable rate debt that LCRA can issue to 25% of its total capitalization (long-term debt plus capital employed as presented periodically in LCRA's financial statements); provided, however, that variable rate debt for which LCRA has hedged its exposure, such as through the use of interest rate swaps, will be excluded from the calculation as variable rate debt. LCRA may periodically retire Parity Debt with available funds, if any, when it determines that it is economically advantageous to do so.

Debt Service Coverage. The Policies include the establishment of a minimum overall debt service coverage ratio of 1.25 times. For purposes of the Policies, debt service coverage is the ratio of a period's ending total revenues minus total operating and maintenance expenses (net of depreciation, amortization and other appropriate adjustments), divided by scheduled debt service on all obligations payable from such revenues. In the event that overall debt service coverage is projected to be below 1.25 times for any Fiscal Year, the LCRA Board will promptly implement a plan, to be recommended by LCRA staff, which could include rate increases, cost reductions or other means to achieve a debt service coverage ratio of 1.25 times. The Policies provide that the LCRA Board will review the targeted level of debt service coverage each year in conjunction with the preparation of the annual Business Plan.

The Policies also require that in the event LCRA's electric generation rates produce total debt service coverage on debt of LCRA attributable to generation assets in excess of 1.25 times for a Fiscal Year, LCRA's staff must submit to the LCRA Board a plan to provide the wholesale electric customers with appropriate credit or other relief in an amount equal to such excess. However, this policy does not apply during periods when such funds are needed to provide equity for the generation capital program or to meet operating reserve requirements.

Rates and Prices. The Policies provide that, to the extent possible, LCRA will design rates and prices to remain competitive, cover the cost of specific services, allow each Business Unit (other than Community Services) to be self-supporting and provide a stable and predictable flow of revenues.

Liquidity and Reserves. LCRA will seek to maintain liquidity and reserves in amounts sufficient to meet approximately two months of LCRA's operation and maintenance expenses and approximately six months of its debt service requirements. If at any time the amount of reserves is less than the target levels set forth in the Policies, the LCRA Board promptly will implement a plan, to be recommended by LCRA staff, to increase rates, reduce costs, or otherwise cause there to be sufficient revenues to replenish the amount of reserves to such target levels within twelve months. As of June 30, 2008, LCRA had approximately \$189 million on deposit, which was approximately \$12.9 million below the target level for operating reserves due to increases in the amount of operating expenses as a result of increases in fuel prices. In accordance with its policy, the Board has implemented a plan to replenish its operating reserves to the target level within twelve months by increasing the fuel component of its rates.

Additionally, unless LCRA exercises its option to receive coverage from TSCorp on the portion of LCRA's debt service allocated to TSCorp under the Initial Contractual Commitment, LCRA would have less liquidity as a result of not "capturing" such coverage. See APPENDIX C - "LCRA TRANSMISSION SERVICES CORPORATION - Initial Contractual Commitment."

Investment Policies. LCRA invests its funds in accordance with its investment policies, State law, and other internal management investment policies of LCRA. See APPENDIX F - "LCRA INVESTMENT POLICY AND INVESTMENT PRACTICES."

Capital Improvements and Incurrence of Additional Indebtedness

LCRA's current projections, based on its latest capital plan, are to spend approximately \$1.8 billion over the current fiscal year and the next four fiscal years for capital improvement projects, excluding any transmission projects to be undertaken by TSCorp. Of this total amount, approximately \$1.54 billion is projected to be debt financed with the remainder funded with internally generated funds of LCRA or with payments from third parties such as the San Antonio Water System, or the Texas Department of Parks and Wildlife. Approximately \$1.4 billion is projected for expenditure by Wholesale Power Services, \$260 million for expenditure by Water Services and \$144 million for Corporate Services and Community Services. For a more detailed description of the capital budgets of each Business Unit and the Corporate Services support service, see the descriptions under "WHOLESALE POWER SERVICES," "TRANSMISSION SERVICES," "WATER SERVICES," "COMMUNITY SERVICES," and "CORPORATE SERVICES," respectively. See also "FACTORS TO BE CONSIDERED IN INVESTING IN THE BONDS - Wholesale Power Agreements and Future Capital Improvements" and "- Capital Spending and Functioning Capital Markets."

It is contemplated that capital improvements of TSCorp for additional electric transmission facilities will be financed by the issuance of Contract Revenue Bonds by LCRA, on behalf of TSCorp, and will not be financed by the issuance by LCRA of any debt payable from Pledged Revenues. LCRA and TSCorp, however, have retained the right, in the Initial Contractual Commitment, to finance additional electric transmission facilities through the issuance of Debt payable from Pledged Revenues. In such case, the Initial Contractual Commitment will be supplemented to provide that TSCorp's obligations thereunder will be increased to pay all debt service associated with such Debt. See APPENDIX C - "LCRA TRANSMISSION SERVICES CORPORATION."

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SELECTED FINANCIAL AND OPERATING INFORMATION

Energy and Sales Statistics

Set forth below is certain information relating to LCRA's sources of electric energy and sales to wholesale and retail customers during each of the Fiscal Years ended June 30, 2004 through June 30, 2008.

	Fiscal Year				
	Ended June 30,				
	<u>2004</u>	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>
Sources of Energy (Mwh) ⁽¹⁾					
Energy Generated					
Steam					
Coal-fired	7,503,964	7,033,946	7,074,925	6,833,454	7,947,791
Gas-fired ⁽²⁾	<u>3,605,491</u>	<u>4,246,965</u>	<u>4,719,119</u>	<u>5,345,017</u>	<u>5,072,004</u>
	11,109,455	11,280,911	11,794,044	12,178,471	13,019,795
Hydro	<u>281,038</u>	<u>568,603</u>	<u>236,935</u>	<u>237,850</u>	<u>369,120</u>
Total Energy Generated	11,390,493	11,849,514	12,030,979	12,416,321	13,388,915
Energy Purchased ⁽³⁾	<u>1,481,671</u>	<u>1,476,116</u>	<u>2,846,891</u>	<u>3,125,974</u>	<u>1,961,819</u>
Total Energy Available for Sale	<u><u>12,872,164</u></u>	<u><u>13,325,630</u></u>	<u><u>14,877,870</u></u>	<u><u>15,542,295</u></u>	<u><u>15,350,734</u></u>
 Wholesale Sales (Mwh) ⁽⁴⁾	 12,872,164	 13,325,630	 14,877,870	 15,542,295	 15,350,734

(1) The information presented in this table is based on ERCOT settlement data and such information is subject to revision based on re-settlements by ERCOT.

(2) Includes GenTex's 100% share of Lost Pines 1 Power Project.

(3) Includes wind power purchases and balancing energy. See "WHOLESALE POWER SERVICES - Additional Supply - Side Resources."

(4) Includes sales to off-system utilities.

Selected Financial Information

The following Special Purpose Statements of Revenues, Expenses and Changes in Equity for each of the Fiscal Years ended June 30, 2004 through June 30, 2008 has been derived from LCRA's audited financial statements. The Other Financial Information section was derived from internal management financial reports.

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Special Purpose Statements of Revenues, Expenses, and Changes in Equity

	Fiscal Year Ended June 30,				
	(Dollars in Thousands)				
	<u>2004⁽¹⁾</u>	<u>2005⁽¹⁾</u>	<u>2006⁽¹⁾</u>	<u>2007⁽¹⁾</u>	<u>2008⁽¹⁾</u>
Operating Revenues					
Electric ⁽²⁾	\$ 627,338	\$ 723,597	\$ 952,523	\$ 992,747	\$ 1,067,070
Water, wastewater and irrigation	44,837	44,484	52,619	56,056	62,766
Other	<u>21,764</u>	<u>34,040</u>	<u>39,247</u>	<u>44,689</u>	<u>61,261</u>
Total operating revenues	<u>\$ 693,939</u>	<u>\$ 802,121</u>	<u>\$ 1,044,389</u>	<u>\$ 1,093,492</u>	<u>\$ 1,191,097</u>
Operating Expenses					
Fuel ⁽²⁾	177,140	179,758	245,686	234,727	285,760
Purchased power ⁽²⁾	155,761	217,192	357,622	372,638	388,182
Operations	161,215	159,633	169,753	201,342	213,942
Maintenance	27,244	33,694	30,968	39,593	34,184
Depreciation, depletion and amortization	<u>82,291</u>	<u>94,119</u>	<u>104,546</u>	<u>106,501</u>	<u>116,120</u>
Total operating expenses	<u>603,651</u>	<u>684,396</u>	<u>908,575</u>	<u>954,801</u>	<u>1,038,188</u>
Operating income	90,288	117,725	135,814	138,691	152,909
Non-operating Revenues (Expenses)					
Interest and other income	4,804	14,189	16,939	31,983	23,535
Interest and other expenses	<u>(98,413)</u>	<u>(118,263)</u>	<u>(120,917)</u>	<u>(139,457)</u>	<u>(155,544)</u>
Non-operating revenues (expenses)	<u>\$ (93,609)</u>	<u>\$ (104,074)</u>	<u>\$ (103,978)</u>	<u>\$ (107,474)</u>	<u>\$ (132,009)</u>
Income before (prior) costs to be recovered from revenues, capital contributions and special item	(3,321)	13,651	31,836	31,217	20,900
(Prior) Costs to be Recovered from Revenues	29,485	17,841	(13,403)	(5,134)	27,761
Capital Contributions	4,789	7,212	11,304	11,477	5,617
Special Item-Loss on Early Defeasance of Debt	—	—	<u>(1,450)</u>	<u>(1,393)</u>	—
Change in Equity	30,953	38,704	28,287	36,167	54,278
Total Equity, Beginning of Year	<u>620,231</u>	<u>651,184</u>	<u>689,888</u>	<u>718,175</u>	<u>754,342</u>
Total Equity, End of Year	<u>\$ 651,184</u>	<u>\$ 689,888</u>	<u>\$ 718,175</u>	<u>\$ 754,342</u>	<u>\$ 808,620</u>
Other Financial Information					
Operating revenues	\$ 693,939	\$ 802,121	\$ 1,044,389	\$ 1,093,492	\$ 1,191,097
Interest and other income available for debt service	<u>5,416</u>	<u>8,556</u>	<u>(6,673)</u>	<u>24,832</u>	<u>13,336</u>
Total	699,355	810,677	1,037,716	1,118,324	1,204,433
Operating expenses, as adjusted ⁽³⁾	<u>516,061</u>	<u>582,746</u>	<u>766,992</u>	<u>838,610</u>	<u>913,417</u>
Net Revenues Available for Debt Service	<u>\$ 183,294</u>	<u>\$ 227,931</u>	<u>\$ 270,724</u>	<u>\$ 279,714</u>	<u>\$ 291,016</u>
Debt service requirements ⁽⁴⁾	\$ 134,205	\$ 160,073	\$ 183,350	\$ 185,071	\$ 207,055
Debt service coverage ratio	1.37x	1.42x	1.48x	1.51x	1.41x

(1) Reflects special purpose financial statements prepared in accordance with the requirements of the Master Resolution, which include the preparation of combined financial statements of LCRA and its Obligated Affiliates (i.e., TSCorp) and excludes non-obligated Affiliates (i.e., GenTex and LCRA Energy). See "DESCRIPTION OF THE REVENUE FINANCING PROGRAM - LCRA Financing Program Special-Purpose Financial Statements."

(2) Sharp increases are due to increases in natural gas prices and spot market energy prices during fiscal years 2005 and 2006.

(3) Operating expenses have been adjusted to include certain non-operating expenses and exclude depreciation, depletion, amortization, and other non-cash miscellaneous expenses.

(4) Debt service requirements reflect bond covenant definitions of debt requirements. Coverage ratio is computed on the basis of actual payments made. Requirements are net of interest expense funded from debt proceeds.

Management Discussion

In addition to the following discussion, APPENDIX B hereto contains "Management's Discussion and Analysis" for Fiscal Years 2008 and 2007, which should be read in conjunction with such discussion.

Electric Revenues. Electric revenues reflected an overall increase of \$439.7 million over the five year period ended June 30, 2008. The increase in electric revenue was primarily because of an increase in sales and higher fuel costs in Fiscal Year 2006 compared to Fiscal Year 2005. LCRA was able to meet increased customer energy demand which resulted in higher sales. In addition, higher fuel revenues resulted from passing on increases in the cost of fuel to LCRA's wholesale electric customers. Electric revenues remained relatively stable from Fiscal Year 2007 to Fiscal Year 2008.

Fuel and Purchased Power. Fuel and purchased power expense reflected an increase of \$341 million over the five year period ended June 30, 2008. This corresponds with the increase in electric revenues. The significant increase in fuel and purchased power expense was caused by the increase in sales and cost of fuel.

Depreciation, Depletion and Amortization. The incremental increases reflected the additional depreciation and amortization expense associated with the increase in capital assets.

Interest and Other Income. The increase in interest and other income from Fiscal Year 2004 to Fiscal Year 2005 was due primarily to an increase in interest rates. In addition, an increase in gains on disposition of property occurred. The increase in interest and other income from Fiscal Year 2006 to Fiscal Year 2007 was primarily due to additional interest income recorded for the securities lending program begun in July 2006. The program was discontinued in May 2007, resulting in a decrease in interest and other income from Fiscal Year 2007 to Fiscal Year 2008. This decrease was partially offset by an increase in gains on disposition of property in Fiscal Year 2008.

Interest and Other Expense. The changes in interest and other expense over the two-year period ended June 30, 2005, is due to an increase in outstanding debt and a decrease in capitalized interest. The decreased capitalized interest relates to reduced construction during that period. In addition, a \$11.9 million loss on disposition of property due to the retirement of assets occurred in Fiscal Year 2005. The \$18.5 million increase in interest and other expense from Fiscal Year 2006 to Fiscal Year 2007 was primarily due to additional interest income recorded for the securities lending program begun in July 2006 as well as in increase in loss on disposal of assets. The \$16.1 million increase in interest and other expense from Fiscal Year 2007 to Fiscal Year 2008 was primarily due to \$10.6 million less interest capitalized to projects in Fiscal Year 2008 compared to Fiscal Year 2007, combined with a \$9.2 million loss on the refunding of LCRA's Transmission Contract Auction Rate Refunding Revenue Bonds (LCRA Transmission Services Corporation Project), Series 2003A. This was offset by a decrease in other interest expense of \$8 million due to the cancellation of the securities lending program in May 2007.

Prior Costs to be Recovered from Revenues. Prior Costs to be Recovered from Future Revenues represents costs that will be recovered in future periods. Prior Costs to be Recovered from Revenues decreased from Fiscal Year 2004 to Fiscal Year 2006 by \$42.9 million due to recognition of costs through rate recovery of depreciation costs. Prior Costs to be Recovered From Revenues increased from Fiscal Year 2006 to Fiscal Year 2008 by \$41.2 million due to deferral of depreciation expense to future periods.

Retirement, Post-Employment Benefits, Etc. For a discussion of LCRA's Retirement, 401(k) Plans, Deferred Compensation and Post-Retirement Benefits, see Note 4 and Note 5 in APPENDIX B hereto. LCRA plans to manage this liability as a current expense in each fiscal year.

OVERVIEW OF LCRA OPERATIONS

Business Units

As previously described, LCRA's operations are divided into four Business Units and its Corporate Services support service. For purposes of the following discussion, amounts received by LCRA from

TSCorp under the Initial Contractual Commitment and the Services Agreement (as defined below) are not included in LCRA management's calculation of the revenues attributed to each of the Business Units.

Wholesale Power Services. Wholesale Power Services provides electric power generation services and fuel acquisition and represents the deregulated segment of LCRA's electric services. For the Fiscal Year ended June 30, 2008, Wholesale Power Services maintained 2,583 MW of net dependable electric generation capacity (excluding 291.9 MW of capacity from hydroelectric generation facilities operated by Water Services, but including 500 MW of capacity from the Lost Pines 1 Power Project). LCRA's management attributes approximately 88% of LCRA's revenues to Wholesale Power Services for the Fiscal Year ended June 30, 2008. See "WHOLESALE POWER SERVICES - GenTex."

Transmission Services. Transmission Services operates the regulated electric transmission and transformation assets and services of TSCorp pursuant to a Services Agreement between LCRA and TSCorp (the "Services Agreement"). For the Fiscal Year ended June 30, 2008, LCRA management attributed approximately 2% of LCRA's revenues to Transmission Services. As noted above, amounts received by LCRA from TSCorp under the Initial Contractual Commitment and the Services Agreement are not included in LCRA management's calculation of the revenues attributed to Transmission Services.

Water Services. Water Services provides LCRA's hydroelectric generation, river management, flood control, raw water sales, agricultural irrigation and water and wastewater utility services. For the Fiscal Year ended June 30, 2008, LCRA management attributed approximately 7% of LCRA's revenues to Water Services, excluding hydroelectric revenues.

Community Services. Community Services provides park and land resource services, natural resource management services and community and economic development services. For the Fiscal Year ended June 30, 2008, LCRA management attributed less than one percent of LCRA's revenues to Community Services.

Corporate Services. Corporate Services support service provides the oversight and support services for LCRA. These oversight functions include environmental and safety, internal audit, accounting, finance, purchasing, computer security, legal services, records management and employee benefits and compensation. The support services consist of corporate communications, customer and community relations, financial planning, employee services, facility services, governmental affairs, regional development, technology services, telecommunications and volunteer services. Approximately 28% of the total services provided by Corporate Services are expensed directly to LCRA's Business Units. The balance of the corporate expenses is allocated among LCRA's Business Units. For the Fiscal Year ended June 30, 2008, LCRA management attributed approximately 2% of LCRA's revenues to Corporate Services.

Affiliates

GenTex. As an Affiliate but not an Obligated Affiliate, GenTex owns the Lost Pines 1 Power Project, a 500 MW high efficiency, combined-cycle gas-fired unit. See "WHOLESALE POWER SERVICES - GenTex."

LCRA Transmission Services Corporation. *The following is qualified in its entirety by reference to the more complete description of TSCorp in APPENDIX C - "LCRA TRANSMISSION SERVICES CORPORATION."*

General. LCRA was required by SB 7 to "unbundle" its electric generation assets from its transmission and distribution assets, and LCRA conveyed all of its electric transmission and transformation assets to TSCorp on January 1, 2002. TSCorp is engaged in the electric transmission and transformation activities formerly carried out by LCRA and has assumed LCRA's obligation to provide, and the right to collect revenues for, electric transmission and transformation services. In such capacity, TSCorp is entitled to receive compensation from all electric distribution service providers using the electric transmission system within ERCOT. As a transmission service provider in the ERCOT region of the State, the rates that TSCorp charges for transmission services are regulated by the PUC and determined pursuant to transmission cost of service rate proceedings filed with, and approved by, the PUC. See APPENDIX C - "LCRA TRANSMISSION SERVICES CORPORATION" herein. The audited financial statements of TSCorp for the Fiscal Years ended June 30, 2008 and June 30, 2007 are included in APPENDIX D.

Initial Contractual Commitment. Pursuant to an Electric Transmission Facilities Contract between LCRA and TSCorp, dated October 1, 2001, as amended (the "Initial Contractual Commitment"), LCRA conveyed, on January 1, 2002, substantially all of its electric transmission and transformation assets to TSCorp. Under the Initial Contractual Commitment, TSCorp is obligated to pay to LCRA a portion of LCRA's Parity Debt debt service allocated to the transferred electric transmission and transformation assets. TSCorp's obligation to make payments pursuant to the Initial Contractual Commitment is prior to the payment of its operating and maintenance expenses and the payment of any of the transmission contract debt, issued by LCRA on behalf of TSCorp or any TSCorp debt issued on a parity therewith or subordinate thereto ("TSCorp Obligations"). As of November 1, 2008, the debt service for approximately \$251.5 million in principal amount of LCRA's Outstanding Parity Debt will be allocated to TSCorp under the Initial Contractual Commitment. See "DESCRIPTION OF THE REVENUE FINANCING PROGRAM - Outstanding and Additional Debt - *Outstanding Debt.*" See also APPENDIX C - "LCRA TRANSMISSION SERVICES CORPORATION - Capital Charge Requirements" for a schedule of annual payments to be made by TSCorp to LCRA pursuant to the Initial Contractual Commitment.

TSCorp has no direct liability with respect to payment of the principal of, premium, if any, or interest on Parity Debt, including the Bonds. TSCorp's obligations are limited solely to payments made to LCRA under the Initial Contractual Commitment. TSCorp's payments under the Initial Contractual Commitment constitute a portion of LCRA's total operating revenues available to pay debt service (2.52% for the Fiscal Year ended June 30, 2008) which have been pledged to the payment of the outstanding Parity Debt, including the Bonds.

LCRA Wholesale Energy Services Corporation. LCRA Energy is an Affiliate of LCRA established in July 2000 primarily to seek new wholesale electric customers for LCRA in the rural and publicly served electric market in the State. See "WHOLESALE POWER SERVICES - LCRA Wholesale Energy Services Corporation."

Other Transfers to Affiliates. LCRA has the ability under State law and the Master Resolution to create future Affiliates. LCRA has no current plans to transfer any other assets to any Affiliate, including LCRA Energy.

WHOLESALE POWER SERVICES

Approach to Operations and Business

Introduction. Wholesale Power Services operates and maintains LCRA's generation assets, and Water Services operates and maintains the hydroelectric assets. In addition, Wholesale Power Services purchases electric power in the deregulated wholesale market to meet its wholesale electric customers' requirements. Wholesale Power Services sells all of its electric generation output to its wholesale customers, except for short-term opportunity sales of surplus amounts to other market participants. The majority of the end-use customer base that is served by LCRA's wholesale electric customers consists of residential users, but a significant portion is also made up of commercial, industrial and other users.

LCRA's generation costs are competitive within ERCOT as a result of a diversified generation portfolio, competitive fuel costs and an active management style. LCRA's diversified generation portfolio includes low cost coal-fired units from which about half of its energy requirements are met, gas-fired units, renewable energy and purchased power contracts. Below are brief discussions of the factors mentioned above and certain other factors about the operation of Wholesale Power Services and the competitive posture of LCRA.

As LCRA has entered the competitive electric marketplace, it has evaluated its generation strategy to focus on two significant areas: (i) to be the provider of choice for electric generation with its existing wholesale electric customers by providing competitively priced power and a high level of customer service and (ii) to manage its electric generation business risks. LCRA has served and plans to continue to provide electric services in primarily rural areas. LCRA is constructing four new 45 MW gas-fired, combustion turbine peaking generation units that are anticipated to be operational by summer 2009. Additionally, LCRA has signed a participation agreement with LS Power for a 100 MW equity ownership interest in the

Sandy Creek Project pulverized coal facility near Waco, Texas, and a 100 MW long-term power supply agreement from the same facility, which is anticipated to be operational by summer 2012. Also, subject to successful negotiation of a related joint participation agreement, LCRA has elected a 300 MW ownership interest in Limestone Unit 3. See " – Generating and Related Resources - *New and Proposed Additional Generation Facilities*" and "- Capital Improvements."

Diversified, Reliable Power and Energy Sources. LCRA has a diversified portfolio of non-nuclear generating assets, including (i) 1,043 MW of western coal-fired net dependable generating capacity completed in the years 1979 through 1988, (ii) 1,040 MW of net dependable existing gas-fired capacity completed in the years 1965 through 1974, (iii) 500 MW of GenTex's gas-fired capacity from Lost Pines 1 Power Project pursuant to contracts with GenTex and (iv) renewable generating sources. These assets serve as the basis for LCRA's strategy to provide competitive power and energy to its wholesale electric customers.

Diversified Fuel Supplies and Delivery Systems. LCRA employs a portfolio approach to its fuel supply that includes a number of cost reduction strategies, such as multiple providers for each fuel source, alternative delivery capability for each plant, intermediate and short-term contracts and LCRA's own gas storage facilities. This approach has fostered competition among fuel suppliers and fuel transportation service providers, helping to reduce fuel costs.

Pricing. LCRA provides a cost-based, time-of-use wholesale pricing program to meet its wholesale electric customers' needs for competitive pricing. For their flexibility, LCRA also provides its wholesale electric customers a market pricing option and an annualized pricing option, as well as account management products such as a customer managed hedging option. See "- Wholesale Power Agreements" and "- Wholesale Energy Pricing Program."

Energy Purchase and Sale and Hedge Management. LCRA seeks to reduce electricity costs through a program of economical market energy purchases, power purchases from GenTex, surplus energy and ancillary service sales and risk mitigation strategies through active hedging of energy and natural gas prices. See "- Additional Supply-Side Resources" and "- Fuel and Fuel Transportation - *Energy Price Risk Management Program.*"

Efficient Management of Existing Assets. The key management personnel for LCRA's major generating facilities have many years of experience operating electric generation plants. LCRA continues to focus on implementing management strategies designed to ensure efficient long-term operation of existing generating assets, such as reliability management, employing non-destructive testing, unit operation and industry experience to allow for optimal planning of major maintenance, repair and replacement efforts.

Wholesale Emphasis. While SB 7 and other applicable State laws have changed the electric generation and transmission markets within the State, LCRA anticipates continuing its role in the State's electric industry as a wholesale provider of power and energy with its long-standing customer base. LCRA intends, within the limits of its long-standing statutory mandate and its existing contractual obligations, to support its wholesale electric customers as they develop their strategic approaches to the changes in the State's electric industry.

Wholesale Power Services has developed the infrastructure and has provided "qualified scheduling entity" services to its wholesale electric customers and the Lost Pines 1 Power Project since the ERCOT independent system operator's assumption of control area responsibilities in July 2001. Wholesale Power Services offers these qualified scheduling entity services to LCRA's wholesale electric customers, the Lost Pines 1 Power Project and in support of any newly acquired customers or generation. See "- GenTex."

Wholesale Electric Customers

LCRA provides wholesale electricity to eight electric cooperatives, one investor owned utility (that acquired an electric cooperative customer of LCRA) and 34 cities that combined serve more than one million people in all or part of 54 counties in central Texas. LCRA's wholesale electric customers are listed on page ii of this Official Statement. PEC, Bluebonnet Electric Cooperative, Inc. ("BEC") and Guadalupe

Valley Electric Cooperative, Inc. ("GVEC") are LCRA's three largest wholesale electric customers. For the Fiscal Year ended June 30, 2008, these three customers represented approximately 58% of LCRA's wholesale electric revenues. LCRA's ten largest wholesale electric customers account for over 80% of its wholesale electric revenues over the same time period.

LCRA has established a Generation Advisory Board (the "GAB") to provide a forum for LCRA's wholesale electric customers to participate in discussions related to generation resource development and strategic planning with the LCRA Board and LCRA's staff. The GAB is composed of five members from the LCRA Board and four members representing a cross-section of LCRA's wholesale electric customers. The GAB meets bi-monthly and meetings are open to all of LCRA's wholesale electric customers.

Wholesale Power Agreements

General. Revenues from the wholesale electric customers represented approximately 97% of LCRA's total kilowatt hour ("Kwh") sales and approximately 91% of LCRA's total electric generation revenues during the Fiscal Year ended June 30, 2008. LCRA has historically provided wholesale electricity to its wholesale electric customers pursuant to long-term requirements wholesale power agreements (the "Original Agreements") which are subject to certain limitations and options described below under "*Options under the Original Agreements*" and "-Wholesale Energy Pricing Program." As discussed below in "*Amendment of Wholesale Power Agreements*," LCRA has entered into amended and restated long-term wholesale power agreements (the "Amended and Restated Agreements") with 31 of its 43 wholesale electric customers, including LCRA's two largest customers, PEC and BEC.

Subject to such limitations and options, each Original Agreement generally provides for the purchase by a wholesale electric customer of its power requirements from LCRA, and LCRA has agreed to supply those requirements. All of LCRA's Original Agreements terminate on June 25, 2016 if notice is given by either party not later than June 25, 2011. If neither party gives a notice to terminate by such date, the term of the respective Original Agreement automatically continues until June 25, 2041. Each of the Amended and Restated Agreements include a waiver of such termination rights thereby allowing such Amended and Restated Agreements to continue until June 25, 2041. In this Official Statement, the Original Agreements and the Amended and Restated Agreements are collectively referred to as the "Wholesale Power Agreements."

LCRA has not requested opinions of counsel to each wholesale electric customer as to the due authorization, execution, delivery and enforceability of the Wholesale Power Agreements. The Original Agreements and 28 of the 31 Amended and Restated Agreements, however, have been submitted to and approved by the Attorney General of the State in connection with the issuance of certain prior defeased debt of LCRA. Applicable State law provides that the effect of such Attorney General approval is to make the Original Agreements and the submitted Amended and Restated Agreements valid and binding obligations, enforceable in accordance with their respective terms and conditions and incontestable for any cause in any State court other than constitutional claims. In connection with the issuance of the Bonds, it is anticipated that the recently executed and delivered Amended and Restated Agreement between LCRA and PEC (the "PEC Restated WPA") will be submitted for approval by the Attorney General of the State.

Amendment of Wholesale Power Agreements. LCRA and its various wholesale electric customers have been in discussions regarding their respective Original Agreements and the future relationship between LCRA and such customers. As of the date hereof, 31 of LCRA's wholesale electric customers consisting of 27 of LCRA's 34 existing city wholesale electric customers, three of LCRA's eight electric cooperative wholesale electric customers, including PEC and BEC, and Cap Rock Energy Corporation, have entered into Amended and Restated Agreements with LCRA. These 31 customers represent approximately 61% of the load served by LCRA in the fiscal year ended June 30, 2008.

The Amended and Restated Agreements waive the provision in the Original Agreements which gave the parties the right to terminate the agreements in 2016, thus allowing the agreements to continue until June 25, 2041. Under such agreements, LCRA will generally supply all electric power and energy to such wholesale electric customers for their use and resale to their retail electric customers. Currently, four of such customers have the right under their respective Amended and Restated Agreements to take up to 10% of their requirements from suppliers other than LCRA. Additionally, the Amended and Restated

Agreements provide that if a wholesale electric customer elects to opt into retail electric competition, such customer shall give LCRA not less than two years notice of the effective date of such decision and such customer will designate itself (or otherwise assign the agreement to another entity if such customer decides not to offer retail electric service) as the "Default Provider of Last Resort," as such term is defined in the Texas Utilities Code, as amended.

The Amended and Restated Agreement that LCRA and BEC have entered into (the "BEC Restated WPA") is similar to the form of the Amended and Restated Agreement discussed in the preceding paragraph, except for the following provisions. The BEC Restated WPA permits BEC to elect to take more of its electric requirements from suppliers other than LCRA (a "Load Release"), through annual stepped reductions (or additions), if it provides LCRA with certain notices. LCRA and BEC have agreed that BEC may not purchase more than 30% of its electric requirements from suppliers other than LCRA, provided that LCRA owns or controls electric generation capacity of not less than a certain threshold amount of the aggregate minimum electric requirements under the various Wholesale Power Agreements with all of LCRA's wholesale electric customers. If LCRA's owned or controlled electric generation capacity falls below such threshold, then BEC may elect to further increase the amount of its electric requirements that it may purchase from suppliers other than LCRA for a specified period of time (a "Capacity Load Release") until LCRA's resources again meet the threshold amount, with the amount of any such increase determined pursuant to formulas contained in the BEC Restated WPA. LCRA has historically owned or controlled through long-term contracts capacity at least equal to the minimum threshold amounts in all of the various forms of Amended and Restated Agreement, and LCRA anticipates continuing to do so in the future.

The BEC Restated WPA also contains a provision that allows BEC to participate, as a joint owner, of any new LCRA electric generation facility in excess of 50 megawatts where BEC's ownership interest will not exceed the percentage of its electric requirements served by LCRA for the prior billing year to the aggregate electric requirements of all of LCRA's wholesale electric customers, unless otherwise agreed by the parties, provided such calculation results in an ownership interest of not less than 10 MW (the "Ownership Option"). BEC may not receive more than 30% of its electric requirements from BEC facilities or other electric suppliers. The BEC Restated WPA also provides for non-binding arbitration as the method to resolve a number of different disputes under the agreement.

On November 19, 2008, LCRA and PEC, LCRA's largest customer, entered into the PEC Restated WPA. The PEC Restated WPA is similar to the form of the BEC Restated WPA discussed in the preceding paragraphs, except for the following provisions. LCRA and PEC have agreed that PEC has the right to a 35% Load Release and a Capacity Load Release below the 35% Load Release. The PEC Restated WPA permits PEC to utilize and LCRA to provide certain backup services for intermittent renewable generation resources, such as wind or solar power, obtained by PEC. The PEC Restated WPA also provides for mutual cooperation for the development of future renewable and alternative electric generation resources, demand-side management programs and other progressive programs and technologies.

The PEC Restated WPA also provides for the creation of the Rates and Resources Council (the "Council"), a non-profit corporation which will be composed of participating wholesale electric customers of LCRA. Pursuant to an agreement between LCRA and the Council, the Council shall be entitled to be consulted and provided certain information that impact the electric generation rates or revenues, including generation resources, power purchase agreements, electric rates, budgets related to electric matters, debt issues allocated to electric revenues of LCRA, etc. The Council shall have the right to make recommendations to the LCRA Board on such matters, though the LCRA Board is not prohibited from taking any action the LCRA Board deems necessary. The LCRA Board adopted a board policy that allows all customers, including those not participating in the Council, access to the same information provided to the Council.

All of the Amended and Restated Agreements also contain a "most favored nations" clause which permits a customer to adopt, within six months of notice thereof, provisions from any other Amended and Restated Agreement LCRA executes with any other wholesale electric customer. In addition to BEC, nine of LCRA's wholesale electric customers, either through exercising the "most favored nations" clause or executing new Amended and Restated Agreements, also have substantially similar rights as BEC to increase the amount of their electric requirements that they can take from suppliers other than LCRA. BEC and such customers constitute approximately 19% of the load served by LCRA in the fiscal year ended June 30, 2008. LCRA anticipates that, as a result of the PEC Restated WPA, a number of customers who have executed

an Amended and Restated Agreement, pursuant to the "most favored nations" clause, may elect to adopt substantive provisions of the PEC Restated WPA. LCRA's management believes that, if all of LCRA's wholesale electric customers adopt the PEC Restated WPA and were to increase the amount of their respective requirements served by providers other than LCRA to the 35% permitted under the PEC Restated WPA, LCRA will be able to comply with all bond covenants and the Policies of the LCRA Board. See "FACTORS TO BE CONSIDERED IN INVESTING IN THE BONDS - Wholesale Power Agreements and Future Capital Improvements."

The various rights of the wholesale electric customers under the Amended and Restated Agreements to take a portion of their electric requirements from suppliers other than LCRA are in addition to any annual pricing mechanisms that LCRA may offer to such customers. See "- Wholesale Energy Pricing Program."

Additionally, LCRA's participation in the Sandy Creek Project and Limestone Unit 3 (if LCRA ultimately participates in such project) triggers, for PEC and BEC, the ability to elect the Ownership Option. At present, only PEC and BEC are of sufficient size to consider participating as joint owners in these projects. Should any of LCRA's other larger wholesale electric customers who have not agreed to an Amended and Restated Wholesale Power Agreement agree to such an agreement with a similar provision, such customers may have the ability to make a similar joint ownership election. See "- Generating And Related Facilities - *New and Proposed Additional Generation Facilities.*"

Eleven⁽¹⁾ of LCRA's wholesale electric customers, who have not executed Amended and Restated Agreements and constitute approximately 35% of LCRA's electric load in the fiscal year ended June 30, 2008, have collectively formed a "Wholesale Power Alliance" for the purpose of developing future wholesale power relationships between such customers and LCRA. Over the past two years, LCRA has been in negotiations with such customers concerning the execution of Amended and Restated Agreements, but to date no definitive agreement has been reached either collectively or individually with such customers.

LCRA continues to have discussions regarding the possibility of amending and restating the Original Agreements with all its remaining customers who have not entered into Amended and Restated Agreements with LCRA, including the customers comprising the Wholesale Power Alliance. While LCRA's management believes that LCRA will not execute any form of Amended and Restated Agreement that will materially adversely affect LCRA and its ability to meet its obligations under the Resolution, including the payment of debt service on the Bonds, LCRA can give no assurances as to if and when such customers may enter into an Amended and Restated Agreement with LCRA or the particular terms of any such agreement. Further, LCRA can give no assurances as to whether any of its wholesale electric customers will execute a different form of agreement or what the impact of any such new agreement may have on its then existing Amended and Restated Agreements through the customers' exercise of their rights under the "most favored nations" provision discussed above.

Power Supply Provisions. LCRA will supply electric power and energy to its wholesale electric customers for their use and resale to their retail customers. LCRA and its customers have agreed that all electric power and energy delivered and purchased under the Wholesale Power Agreements will be consumed wholly within the area in the State that comprised LCRA service territory in 1975. LCRA will use all reasonable means to furnish all the power and energy requirements of those contracting with it, whether such requirements are satisfied from power generated by LCRA's facilities or from power supplied by a third party.

Options under the Original Agreements. The Original Agreements provide the wholesale electric customers with certain options to "cap" their respective loads. To date, these "capping" provisions have generally not been included in the Amended and Restated Agreements.

The Original Agreements generally provide that, if LCRA seeks to certify a new base load power generation unit without having first obtained the written consent of a wholesale electric customer, then upon written notice to LCRA, the non-consenting customer is entitled to limit its purchases of power from LCRA to an amount which bears the same ratio to the total generation capacity of LCRA as the energy purchased

⁽¹⁾ Cities of Boerne, Georgetown, Kerrville, New Braunfels, Seguin and Yoakum and electric cooperatives of Bandera, Central Texas, Fayette, Guadalupe Valley and San Bernard.

by such customer during the twelve-month period prior to the date of the written notice to the total energy generated by LCRA during such twelve-month period (the "Capped Load"). LCRA has agreed that the rates charged to such non-consenting wholesale electric customers for the Capped Load shall not include any of the costs associated with the construction and operation of the new base load generating unit. In accordance with this provision of the Original Agreements, any such non-consenting wholesale electric customer may satisfy its requirements in excess of the Capped Load from sources other than LCRA, and LCRA will not be responsible for supplying any requirements in excess of the Capped Load. Once a Capped Load is established, it can be further modified if LCRA seeks to certify a subsequent base load power generation unit, provided that such modification has a system-wide benefit to LCRA. See "- Generating and Related Resources - *New and Proposed Additional Generation Facilities.*"

Two of LCRA's wholesale electric customers, City of Kerrville Public Utility Board and the City of New Braunfels Utilities, have capped their respective electric loads by electing in February 2004 not to participate in the costs associated with the LCRA - GenTex power sales agreement related to GenTex's acquisition of the Acquired Interest in the Lost Pines 1 Power Project. For the Fiscal Year ended June 30, 2008, the aggregate total load represented by these two customers was approximately 9% of the aggregate electric load served by LCRA, and the load lost by such capping elections, as calculated by LCRA, represents a de minimis amount of LCRA's aggregate load served. See "- GenTex."

Additionally, a wholesale electric customer of LCRA, who has not agreed to an Amended and Restated Wholesale Power Agreement (including the members of the Wholesale Power Alliance), may also exercise its right under its Original Agreement to have a Capped Load with respect to LCRA's participation in the Sandy Creek Project and Limestone Unit 3 (if LCRA ultimately participates in the project), as the case may be. LCRA has given notice to such customers regarding LCRA's participation in the Sandy Creek Project and such customers shall have until February, 2009 to elect a Capped Load. LCRA has agreed that the rates charged to such non-consenting wholesale electric customers for the Capped Load shall not include any of the costs associated with one or both of such projects, as the case may. See "- Generating And Related Facilities - *New and Proposed Additional Generation Facilities.*"

Additionally, in the Original Agreements LCRA has agreed to jointly plan with some of its wholesale electric customers for the construction of up to 10% of their peak load requirements. Other customers may elect, with two years notice to LCRA, to install or otherwise acquire their own independent peaking capacity in an amount not to exceed 10% of such wholesale electric customer's peak demand during the preceding 12 months if LCRA has a need for peaking capacity and decides not to construct it. Except for the construction of such a peaking load unit to satisfy the 10% requirement or otherwise acquiring 10% of peaking capacity, under the Original Agreements none of the wholesale electric customers may obtain their energy requirements from sources other than LCRA without the consent of LCRA. LCRA, currently in an annual pricing program, permits the wholesale electric customers to obtain this portion of their electric requirements from third parties. See "- Wholesale Energy Pricing Program."

Agreements Not Transferable. Neither the Wholesale Power Agreements nor any interest therein is transferable or assignable by either party without the written consent of the other party, except that wholesale electric customers financed by the federal Rural Utilities Service may assign their interest to the United States without the consent of LCRA. Additionally, SB 7 provides, in part, that the implementation of the electric utility industry restructuring resulting from SB 7 shall not impair existing contracts.

Wholesale Energy Pricing Program

The LCRA Board, based on staff recommendations and input from LCRA's wholesale electric customers, approves a wholesale energy pricing program that is designed to reflect the outlook for fuel and power cost requirements. For calendar year 2008, this program incorporated a range of products that were designed to meet individual wholesale electric customers' business needs, including: (i) a Natural Gas Hedging Option ("Hedging Option") that enables wholesale electric customers to make their own individual hedging decisions and lock in prices for all or a portion of their forecasted natural requirements; (ii) a Pay As You Go Option ("Pay As You Go") that enables wholesale electric customers to receive monthly adjustments for previous month fuel and purchased power activities (a charge if under-collected; a credit if over-collected); and (iii) a Market Pricing Option ("MPO") that enables wholesale electric customers to

diversify their power supply and acquire up to 10% of energy from other electric providers, provided that the aggregate system MPO load will not exceed 10% of total forecasted 2008 system energy requirements.

In calendar year 2008, the MPO was elected by ten LCRA wholesale electric customers. These customers will receive some portion of their electric supply in 2008 from third party providers, and some of these customers have acquired the 10% option from fourteen other customers who otherwise elected to receive all of their respective electric requirements from LCRA. The MPO for 2008 represents approximately 9% of the aggregate electric load served by LCRA. In calendar year 2009, the MPO has been elected by nine wholesale electric customers and some of these customers acquired the 10% option from sixteen other customers who otherwise elected to receive all their respective electric requirements from LCRA. The MPO for 2009 represents approximately 9% of the aggregate load served by LCRA.

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Generating and Related Facilities

The generating capacity of LCRA's plants now in service, including its interests in jointly-owned plants, is summarized below:

Electric Generation Resources

<u>Generation Resources</u>	Generator Nameplate Rating (MW)	Year in Service or of Major <u>Rehabilitation</u>	Net Dependable Capacity ⁽¹⁾ Amount (MW)	LCRA Total Net Dependable Capacity Percent (%)
Hydroelectric: ⁽²⁾				
Buchanan Plant				
Unit No. 1	18.2	1999	18.2	0.63
Unit No. 2	18.2	1999	18.2	0.63
Unit No. 3	14.9	1950	14.9	0.52
Inks Plant				
Unit No. 1	14.0	1998	14.0	0.49
Granite Shoals Plant				
Unit No. 1	30.0	2002	30.0	1.04
Unit No. 2	30.0	2003	30.0	1.04
Marble Falls Plant				
Unit No. 1	21.4	2007	21.4	0.74
Unit No. 2	21.4	2008	21.4	0.74
Marshall Ford Plant				
Unit No. 1	36.0	1986	36.0	1.25
Unit No. 2	34.5	2001	34.5	1.20
Unit No. 3	36.0	1986	36.0	1.25
Austin Plant				
Unit No. 1	8.4	1993	8.4	0.29
Unit No. 2	<u>8.9</u>	1993	<u>8.9</u>	<u>0.31</u>
Total Hydroelectric Capacity	291.9		291.9	10.15
Natural Gas:				
Sim Gideon Power Plant				
Unit No. 1	136.0	1965	140.0	4.87
Unit No. 2	136.0	1968	140.0	4.87
Unit No. 3	351.0	1972	340.0	11.83
Lost Pines Power Plant				
Unit No. 1 ⁽³⁾	609.0	2001	500.0	17.39
Thomas C. Ferguson Power Plant				
Unit No. 1	<u>446.0</u>	1974	<u>420.0</u>	<u>14.61</u>
Total Natural Gas Capacity	1,678.0		1,540.0	53.57
Coal:				
Fayette Power Project				
Unit No. 1 ⁽⁴⁾	307.5	1979	299.0	10.40
Unit No. 2 ⁽⁴⁾	307.5	1980	299.0	10.40
Unit No. 3	<u>460.0</u>	1988	<u>445.0</u>	<u>15.48</u>
Total Coal Capacity	<u>1,075.0</u>		<u>1,043.0</u>	<u>36.28</u>
Total Capacity	<u>3,044.9</u> ⁽⁵⁾		<u>2,874.9</u> ⁽⁵⁾	<u>100.00</u>

(1) The Net Dependable Capacity for fossil units shown represents the minimum capacity available in all seasons of the year, as defined by the North American Electric Reliability Corporation.

(2) Operated by Water Services. Additional engineering and testing has yielded higher hydroelectric generator outputs than the original nameplate values. Lake levels change from time to time; however the ratings above reflect outputs based on full lake levels.

(3) Represents GenTex's 100% share in Lost Pines Power Plant Unit 1. The output of GenTex's Original Interest (50%) in the unit has been assigned to LCRA by all of LCRA's wholesale electric customers, and the output of the Acquired Interest (the remaining 50%) in the unit has been obtained by LCRA pursuant to a power sales agreement with GenTex. See "- GenTex."

(4) Represents LCRA's 50% ownership share of FPP 1 and FPP 2.

(5) Does not include power purchased from wind projects or other purchased power resources. See "- Additional Supply-Side Resources."

Electric Generation Sources By Category. Set forth below is a table containing information concerning the nameplate power resources of Wholesale Power Services and Water Services, as well as net power generated, classified by source of energy for the Fiscal Year ended June 30, 2008. For data relating to net power generated by LCRA's generation sources for the fiscal years ended June 30, 2004 through June 30, 2008, see "SELECTED FINANCIAL AND OPERATING INFORMATION - Energy and Sales Statistics."

<u>Capacity Sources</u>	Generator Nameplate		Generation	
	<u>Capacity (MW)</u>	<u>% of Capacity</u>	<u>(Mwh)⁽³⁾</u>	<u>% of Generation</u>
Hydro Generation ⁽¹⁾	291.9	9.59	369,120	2.76
Steam (Natural Gas) ⁽²⁾	1,678.0	55.11	5,072,004	37.88
Steam (Coal)	<u>1,075.0</u>	<u>35.30</u>	<u>7,947,791</u>	<u>59.36</u>
Total	3,044.9	100.00	13,388,915	100.00

(1) Operated by Water Services.

(2) Includes GenTex's 100% share on the Lost Pines 1 Power Project.

(3) Represents total electric system net generation for all transactions. Based on ERCOT data, which could be modified due to re-settlements by ERCOT.

Historical Electric Demand. The following table summarizes the historical electric demand peaks of LCRA's wholesale electric customers for calendar years 2004 through 2008.

<u>Calendar Year</u>	<u>Summer Peak Demand MW⁽¹⁾⁽²⁾</u>	Annual Increase	<u>Winter Peak Demand (MW)⁽¹⁾⁽²⁾</u>	Annual Increase
		<u>(Decrease) %</u>		<u>(Decrease) %</u>
2004	2,834	(1.84)	2,836	3.24
2005	3,040	7.27	3,049	7.51
2006	3,163	3.98	3,285	19.59
2007	2,998	(5.22)	2,956	(10.02)
2008	3,211	7.09	-	-
Average Annual Increase:		3.17%		3.15%

(1) Peaks are based on LCRA's wholesale electric customers' metered loads, which include the 10% market pricing option loads that are not served by LCRA and capped customers' loads that exceeded their respective caps. See "- Wholesale Energy Pricing Program." The energy required to meet the peaks shown includes power purchased from outside sources in addition to power from LCRA's own generation plants. See "- Additional Supply-Side Resources." Historical demand has not been adjusted to normalize temperature variations that affect the consumption of energy.

(2) LCRA peaks in the summer and winter. LCRA currently anticipates that it will continue to peak during the winter months in years with unusually cold weather in LCRA's service area. Winter peaks are historically of short duration. Numbers since 2005 Winter Peak include the addition of the City of Brady, Texas as a new wholesale electric customer of LCRA. For each calendar year, the corresponding Winter Peak represents the peak demand during the period from the month of December of that year through March of the subsequent year.

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Historical Electric Generation. The following table summarizes LCRA's annual electric system generation for the Fiscal Years ended 2004 through 2008.

<u>Fiscal Year Ended</u>	<u>Generation</u>	<u>Annual Increase</u>
<u>June 30,</u>	<u>Mwh ⁽¹⁾</u>	<u>(Decrease)</u>
		<u>%</u>
2004	11,390,493	(2.98)
2005	11,849,514	4.03
2006	12,030,979	1.53
2007	12,416,321	3.20
2008	13,388,915	7.83
Average Annual		4.39%

⁽¹⁾ Generation amounts do not include purchased power sources, which may be used to meet peak load demand. See "- Additional Supply-Side Resources."

Coal-Fired Electric Plants. *Fayette Power Project Unit Nos. 1, 2 and 3 ("FPP 1," "FPP 2" and "FPP 3," respectively).* The Fayette Power Project, located approximately eight miles east of the City of La Grange, in Fayette County, Texas, consists of three units, two of which, FPP 1 and FPP 2, are coal-fired generating units jointly owned by LCRA and the City of Austin, Texas ("Austin"). FPP 3, is a coal-fired generating unit owned entirely by LCRA. Pursuant to a participation agreement signed in September 1974, LCRA and Austin each own a 50% undivided interest as tenants in common in the Fayette Power Project site and certain common facilities of FPP 1 and FPP 2, and each is entitled to 50% of the generating capacity of such units. LCRA is designated as project manager for the operation and maintenance of FPP 1 and FPP 2 under the participation agreement.

LCRA committed in its flexible air quality permit, issued by the Texas Commission on Environmental Quality ("TCEQ") in 2002, to install scrubbers on FPP 1 and FPP 2 by October 2012. This permit authorizes LCRA to undertake efficiency improvement and maintenance projects at FPP without the threat of triggering the new source review provisions of the Clean Air Act. With the installation of scrubbers on FPP 1 and FPP 2, LCRA will be well positioned with respect to possible future sulfur-dioxide reduction requirements. See "- Capital Improvements" and "REGULATORY MATTERS - Environmental Regulation."

Gas-Fired Electric Plants. *Sim Gideon Power Plant ("Gideon").* Gideon, which is located in Bastrop County, Texas, is a semi-outdoor type plant with steam turbines and auxiliaries located indoors, natural gas-fired outdoor boilers and appurtenant switchyard, substation and transmission facilities connecting the plant to the transmission system of TSCorp. LCRA has designated the Gideon site as the Lost Pines Power Park, which includes the Lost Pines 1 Power Project owned by GenTex. See "- GenTex."

Thomas C. Ferguson Power Plant ("Ferguson"). This gas-fired electric generating plant is located on Lake Lyndon B. Johnson in Llano County, Texas. The facilities include the plant, which is a semi-outdoor type with the steam turbine and auxiliaries located indoors, a natural gas-fired outdoor boiler and the appurtenant switchyard, substation and transmission facilities connecting the plant to the transmission system of TSCorp.

Gideon and Ferguson are now used as sources of peaking and intermediate power supply as well as being used to provide ancillary services to ERCOT. LCRA presently has no intention of decommissioning these plants. Wholesale Power Services periodically evaluates the net value of its older gas-fired steam units to determine if it is prudent and economical to continue to operate and maintain them. The most recent evaluation shows that the revenues from the sale of energy and ancillary services from these units offsets the cost of operations, maintenance and capital improvements necessary to keep them available.

New and Proposed Additional Generation Facilities. The Winchester Power Park Peaker Project ("Winchester Project") is currently under construction. These four new 45 MW gas-fired, combustion

turbine peaking generation units are scheduled for completion in the summer of 2009. The addition of this quick-start, high-efficiency peaking generation, located near the community of Winchester in Fayette County, will expand the operational flexibility of LCRA's generation plant portfolio to reduce dependence on power purchases and related exposure to market prices. The cost of the Winchester Project is estimated to be approximately \$170 million which LCRA is funding through the issuance of debt. See "– Capital Improvements" and "FACTORS TO BE CONSIDERED IN INVESTING IN THE BONDS - Wholesale Power Agreements and Future Capital Improvements."

In addition, LCRA has signed a 100 MW participation agreement and a 100 MW purchase power agreement with LS Power, a privately held company, for a combined 200 MW from the Sandy Creek Project, a 900 MW pulverized coal facility under construction near Waco, Texas. In accordance with requirements of the United States Environmental Protection Agency, the facility will employ the best available control technology to minimize emissions. Under such agreements, LCRA will acquire a 100 MW equity ownership interest for approximately \$231 million and purchase 100 MW of capacity for a period of 30 years for approximately \$26.7 million annually. The facility is anticipated on-line by the summer of 2012. The Sandy Creek Project's environmental controls will include selective catalytic reduction to control nitrogen oxide, a limestone scrubber to reduce sulfur dioxide and halogenated activated carbon and fabric filters to reduce mercury. LS Power received its air permit for the project from the Texas Commission on Environmental Quality on July 18, 2006 and construction began in fall 2007 in McLennan County, Texas. See "– Capital Improvements" and "FACTORS TO BE CONSIDERED IN INVESTING IN THE BONDS - Wholesale Power Agreements and Future Capital Improvements."

LCRA has also executed a Memorandum of Understanding (the "MOU"), with NRG Texas LP ("NRG") regarding LCRA's equity participation in new 800 MW Limestone Unit 3 proposed to be constructed by NRG at its Limestone Electric Generating Station in Limestone County, Texas anticipated to be operational in 2013. On December 3, 2007, LCRA, pursuant to the MOU, elected to take a 300 MW ownership interest in Limestone Unit 3, subject to the successful negotiation of a comprehensive joint participation agreement with a single purpose wholly owned subsidiary of NRG related to the ownership and management of Limestone Unit 3. The MOU expires on December 31, 2008, unless extended by the parties. It is anticipated that such agreement will permit any party to withdraw from participation in the new unit (i) prior to the time notice to proceed with construction is given under the yet to be executed engineering, procurement and construction agreement with a general contractor of Limestone Unit 3 (with a maximum LCRA termination cost not to exceed approximately \$23 million) or (ii) certain other events. LCRA estimates its costs related to the development of Limestone Unit 3 to be approximately \$700 million (if LCRA ultimately participates), which is anticipated to be funded with debt. LCRA can give no assurances as to whether LCRA will ultimately enter into a joint participation agreement with respect to Limestone Unit 3. See "– Capital Improvements" and "FACTORS TO BE CONSIDERED IN INVESTING IN THE BONDS - Wholesale Power Agreements and Future Capital Improvements."

Hydroelectric Plants. The hydroelectric facilities are operated by Water Services and revenues derived from these facilities are credited to that Business Unit. See "WATER SERVICES - Hydroelectric Facilities and Dams."

Additional Supply-Side Resources

To meet its load requirements LCRA enters into power purchase arrangements to supplement its own generating capacity. The electric markets in the State currently have surplus power supplies and accordingly, LCRA has been relying on the short term power market to meet its purchased power needs. LCRA has entered into contracts with multiple suppliers to provide such supplemental power in order to meet its energy requirements for the winter period from December 2008 through February 2009. In addition, LCRA continues to monitor energy market conditions and prices and will be seeking competitive purchase power opportunities for upcoming summer and winter seasons, including for the summer period from June through September 2009.

LCRA purchases a total of 116 MW of wind energy from various wind power providers located in far west Texas.

Capital Improvements

Capital improvements for Wholesale Power Services, based on LCRA's latest capital plan, are estimated to total approximately \$1.4 billion over the current fiscal year and the next four fiscal years. These improvements include LCRA's potential participation in Limestone Unit 3, 50% of LCRA's acquisition of a 100MW interest in the Sandy Creek Project, construction of the Winchester Project, a project to add flue gas de-sulfurization scrubbers to FPP 1 and FPP 2, as well as other upgrades, refurbishments and capital replacements to existing generating assets. Currently, approximately \$1.3 billion is planned to be financed with debt of LCRA.

LCRA's annual generation resource planning process continues to monitor and develop longer term generation and purchase strategies by identifying various generation technology additions ranging from near term simple cycle gas turbines to physically hedge against high market prices during peak demand periods to the development of additional baseload generation to be available in the 2012 to 2014 time frame. See "—Generating and Related Resources - *New and Proposed Additional Generation Facilities*" and "FACTORS TO BE CONSIDERED IN INVESTING IN THE BONDS - Wholesale Power Agreements and Future Capital Improvements."

Fuel and Fuel Transportation

LCRA uses a portfolio approach to its fuel supply which centers on fostering competition among suppliers to reduce fuel costs. Strategies used include having multiple providers for each fuel source, alternative delivery capability for each plant, intermediate and short-term contracts, LCRA's own gas storage facilities and active management of fuel and energy costs.

Western Coal. The fuel for the Fayette Power Project units comes from mines in Wyoming's Powder River Basin and more than half of the annual fuel requirements are supplied under annual and multi-year contracts. The total annual requirements of FPP 1 and FPP 2 are approximately five million tons. For calendar year 2008, approximately 1.5 million tons are being supplied to FPP 1 and FPP 2 pursuant to a multi-year contract with a term that extends through the end of the calendar year. For 2008, 2.5 million additional tons are being supplied through three other separate annual contracts. For calendar year 2009, three million tons will be supplied through multiyear contracts. For calendar years 2010 and 2011, approximately 30% of coal requirements are currently under contract.

The total annual coal requirements for FPP 3 are approximately two million tons. In calendar year 2008 approximately 85% of such amount is being provided pursuant to two contracts with terms that extend through the end of the calendar year. An additional multi-year contract has been executed that provides approximately 25% of FPP 3's coal needs for calendar years 2009 through 2011.

The remaining coal requirements for FPP 1, FPP 2 and FPP 3 are being supplied under a mix of shorter-term contracts at spot market prices from multiple vendors. LCRA's management does not anticipate difficulties in purchasing the remaining requirements at the then prevailing market prices because it utilizes multiple suppliers, types of coal contracts that provide flexibility and an efficient procurement process.

Rail Transportation. LCRA and its Fayette Power Project partner, Austin, receive coal transportation under a multi-year contract with the Union Pacific Railroad that became effective April 1, 2008. In addition, LCRA and Austin also have a multi-year coal transportation arrangement for the three FPP units with the BNSF Railway through their common carrier pricing authority.

Lower costs for the transportation of coal in larger capacity railcars provide an incentive and potential cost justification for replacing a portion of the current FPP rail fleet. Accordingly, LCRA is in the process of replacing a portion of the current fleet with new, larger capacity cars.

Gas Supply. LCRA's gas-fired power plants, Gideon and Ferguson, as well as GenTex's Lost Pines 1 Power Project, are supplied by short-term purchase agreements and two long-term supply contracts. The spot contracts provide that each supplier may bid for all or a portion of each month's spot requirement. LCRA may then buy its requirements from selected suppliers at the lower of the bid price or an index price. Bid prices are either bid at a select hub into LCRA's firm transport receipt points, or into LCRA's own

pipeline receipt points that connect directly to LCRA's plants or to the Hilbig Gas Storage Facility. The two long term gas supply contracts are based on market index pricing and they provide approximately 40% of LCRA's base and variable flow gas supply. LCRA has entered into an additional multi-year natural gas supply contract, scheduled to commence in January 2009, that will supply approximately 10% of LCRA's total needs in the next five years.

Natural gas prices have historically been volatile and, within the last several years, there has been increasing pressure toward sustained higher prices. Even in such conditions, however, LCRA's management believes that LCRA is in a strong position to minimize the impact of potentially higher gas prices due to LCRA's diverse fuels and generation portfolio of which low-cost coal fired generation comprises about half of LCRA's total energy production. In addition to coal, portfolio diversification includes purchased power, hydroelectric power, and wind power. LCRA uses multiple types of natural gas contracts that provide additional flexibility and employs a strategy of storing natural gas supplies when market prices are lower so that they can be utilized when prices increase or supplies are limited. LCRA's management believes this flexibility and diversification will minimize the impact of the volatility in the natural gas prices and enable LCRA to make adjustments to remain competitive. See "- Fuel and Fuel Transportation," "- Storage" and "- Energy Price Risk Management Program."

Gas Transportation. LCRA has entered into long-term firm and interruptible gas transportation contracts with two intrastate pipeline companies for gas supply transport to the Gideon Plant, the Ferguson Plant and the Hilbig Gas Storage Facility, as well as GenTex's Lost Pines 1 Power Project. These contracts continue through 2014, giving LCRA long term gas transport reliability, as well as flexibility to purchase gas from multiple gas suppliers at competitive market hubs. LCRA also owns or has capacity rights to over 110 miles of gas pipeline connecting its gas-fired generation plants and its natural gas storage facility to major gas markets. LCRA is also beginning a project to interconnect LCRA's natural gas pipeline system to an additional third party pipeline and to construct associated natural gas compression and metering facilities. The third party pipeline originates in a supply-rich area of west Texas, and the interconnection will help serve the Winchester Power Project that is currently under construction and provide access to new supply sources and more opportunities for competitively priced natural gas purchases.

Storage. LCRA operates the Hilbig Gas Storage Facility which was developed from a nearly depleted oil field in Bastrop County, Texas. The facility currently has a working capacity of 3.6 billion cubic feet and an average injection and withdrawal deliverability capacity of 70 million cubic feet per day. The Hilbig Gas Storage Facility has lowered average gas costs for LCRA through the storage of gas purchased at favorable prices, reducing requirements of higher price "swing" gas supply and providing increased reliability and the displacement of higher cost fuel oil during gas curtailments. The storage capacity is reserved for use in LCRA's plants and for participating in risk management transactions within program guidelines. The Hilbig Gas Storage Facility has also helped facilitate LCRA's participation in the ancillary services market.

Energy Price Risk Management Program. LCRA conducts an energy, fuel oil and natural gas price risk management program, considering risk for physical as well as financial positions. Market risk limits are set by the Board and are currently set at a level that is 50% of LCRA's projected annual natural gas consumption, with such limit estimated to be approximately \$80 million for calendar year 2008. LCRA participates in the futures and options markets to hedge the price of natural gas and oil products used in its electric generating plants as well as that stored in the Hilbig Gas Storage Facility. LCRA has developed risk management procedures and controls designed to ensure the financial integrity of the program. The program, which is internally monitored, has been operating successfully since its inception in 1994. These procedures include segregation of duties between the initiating individual, approvers of transactions, and confirmation of transactions. The program is subject to volumetric and position limits that are set by management. Additionally, LCRA monitors the financial situation of its counterparties closely and institutes stricter credit requirements and payment terms for any counterparty that experiences financial difficulties. A management oversight group meets monthly to review the status of the program. The LCRA Board is provided financial reports by management at each board meeting.

GenTex

GenTex is an Affiliate of LCRA and is governed by a board of directors which consists of five members of the LCRA Board and four representatives of LCRA's wholesale electric customers. GenTex owns Lost Pines 1 Power Project, a 500 MW gas-fired combined-cycle generation facility located at LCRA's Lost

Pines Power Park in Bastrop County, Texas. Originally GenTex held an undivided 50% interest in the Lost Pines 1 Power Project (the "Original Interest"), the output of which is sold to all of LCRA's wholesale electric customers based on their respective share of the revenues of LCRA received during the period in which LCRA funded the project and each customer has assigned its rights to such output to LCRA which permits LCRA to operate the project as part of its electric generation system. In January 2004, GenTex obtained full ownership of the Lost Pines 1 Power Project by purchasing the remaining undivided 50% interest in the Lost Pines 1 Power Project (the "Acquired Interest") and entered into a long-term power sales agreement with LCRA pursuant to which GenTex has agreed to sell the output of the Acquired Interest to LCRA.

The output of the Original Interest is sold to LCRA's wholesale electric customers under a pricing structure that does not include any debt component because there is no debt associated with the project. The agreement with LCRA's wholesale electric customers provides for GenTex to sell energy to the customers at a price recovering operating expenses. All of LCRA's wholesale electric customers have executed such agreements. Each of these customers has assigned its contract right to its respective share of the output of the Lost Pines 1 Power Project to LCRA and such project is operated and its power dispatched economically as a part of LCRA's electric generation system. Additionally, the wholesale customers have a right to purchase an interest in Lost Pines 1 Power Project equal to their share of the output, at a nominal cost, in the event GenTex decides to sell its Original Interest in the plant. Ten customers have amended their contracts and assigned their portion of the GenTex output to LCRA to be utilized as part of LCRA's generation mix.

With respect to the Acquired Interest, GenTex executed a power sales agreement with LCRA whereby LCRA purchased all of the output from the 250 MW of the Lost Pines 1 Power Project acquired by GenTex. LCRA pays only the fuel expenses and operation and maintenance expenses under the LCRA - GenTex power sales agreement for the output of the Acquired Interest. The term of the LCRA - GenTex power sales agreement extends through the operational life of the plant, estimated to be in excess of 30 years. LCRA uses the electric power received pursuant to the LCRA - GenTex power sales agreement as part of LCRA's generation mix to supply the electric requirements of its wholesale electric customers that have opted to participate in the costs associated with the power sales agreement. The transactions regarding the acquisition of the Acquired Interest triggered an option under the Original Agreements for wholesale electric customers to cap their respective loads and not participate in the costs associated with the LCRA--GenTex power sales agreement. Two of LCRA's 43 current wholesale electric customers have capped their respective loads and are not participating in the costs of the LCRA--GenTex power sales agreement. See "- Wholesale Power Agreements - *Options under the Original Agreements.*"

LCRA Wholesale Energy Services Corporation

LCRA Energy is an Affiliate of LCRA established in July 2000 primarily to seek new wholesale electric customers for LCRA in the rural and publicly served electric market in the State. LCRA Energy's objective is to reduce LCRA's electric deregulation risk as current wholesale customers decide whether and when to allow retail customer choice, by being positioned to maximize the use of LCRA's existing generation assets. LCRA Energy is a nonprofit corporation created under Chapter 152 of the Texas Water Code, as amended, and operating under Section 32.053 of the Texas Utilities Code, as amended. The staff and business services systems required to operate LCRA Energy are provided through a services agreement with LCRA. Since its creation, LCRA Energy has not secured any customers and is currently not actively seeking new customer opportunities.

TRANSMISSION SERVICES

In January 2002, LCRA transferred its electric transmission and transformation assets to TSCorp. Transmission Services currently operates the transmission and energy control system of TSCorp. Transmission Services will continue its operations in the role of providing the majority of the personnel to TSCorp pursuant to the Services Agreement, described previously, in "OVERVIEW OF LCRA OPERATIONS - LCRA Transmission Services Corporation" and in APPENDIX C - "LCRA TRANSMISSION SERVICES CORPORATION - Business Operations."

The operations of TSCorp are carried out by LCRA's Transmission Services Business Unit staff pursuant to the terms of the Services Agreement. The Services Agreement sets forth the terms and

conditions under which LCRA will perform, or cause to be performed, the operation and maintenance of the existing electric transmission and transformation assets of TSCorp and any assets acquired in the future (except as otherwise provided by agreement between TSCorp and a third party). LCRA provides design, engineering, construction, and traditional general and administrative functions, including accounting, human resources, legal services, purchasing and other related services. In return for such services, LCRA is paid by TSCorp based on the cost of providing such services, as required by certain provisions of SB 7. Detailed records of time and expenses incurred are maintained in order to insure full cost recovery in future rate cases.

WATER SERVICES

Introduction

Water Services operates LCRA's hydroelectric generation, river management, flood control, raw water sales, agricultural irrigation, water quality monitoring and water and wastewater utility services.

The LCRA Act establishes LCRA as a conservation and reclamation district with a water service area that includes all or a portion of 33 counties in the lower Colorado River watershed. Within this water service area, which is depicted on page ii of this Official Statement, LCRA has the responsibility of harnessing the Colorado River and its tributaries and making the waters productive for the people within such area. LCRA is empowered by the State to use the waters of the Colorado River for beneficial purposes including irrigation, municipal consumption, generation of electric energy, reclamation of arid lands and the creation of lakes for water storage, flood control and recreation. LCRA carries out several of these responsibilities pursuant to a water management plan that is approved by the TCEQ. The TCEQ has appellate jurisdiction over wholesale water and wastewater rates. In a coordinated effort with its Water Services and Community Services Business Units, LCRA carries out the environmental, land management and recreational responsibilities with respect to the Highland Lakes system, which is comprised of two water storage reservoirs, Lakes Buchanan and Travis, and three intermediate pass-through reservoirs, Lakes Inks, LBJ and Marble Falls. Lake Austin, which is owned by Austin, but operated by LCRA by agreement, may be referred to as part of the Highland Lakes system from time to time.

As a conservation and reclamation district, LCRA is authorized to conserve and develop the lands, forests and water of the district and to study and correct both artificial and natural sources of pollution which may affect the ground and surface waters within its statutory district. LCRA is also empowered to provide water and wastewater treatment services within the central Texas area.

LCRA's Water Rights and Supply Obligations

LCRA currently has a combined firm yield of 445,266 acre-feet of firm water per year available for use from two water supply reservoirs, Lakes Buchanan and Travis, which is the estimated amount of firm water available after reducing the yield by approximately 90,000 acre-feet per year in order to satisfy an agreement with the Colorado River Municipal Water District. The combined firm yield is the maximum annual quantity of water that can be supplied from a water source without shortages while honoring upstream and downstream senior water rights during a repetition of the historical critical drought period. An additional firm water supply of about 200,000 acre-feet per year is currently available from four downstream run-of-the-river water rights. With permit amendments and off-channel storage, these four rights may yield as much as 400,000 acre-feet per year of firm water supply.

In accordance with a 1988 State District Court proceeding regarding the final adjudication of water rights in the lower Colorado River basin, LCRA has the right to use 1,500,000 acre-feet of water per year from Lake Buchanan and Lake Travis. LCRA cannot commit to supply more water from Lakes Buchanan and Travis on a firm basis than the combined firm yield, although it can commit to provide water from other sources. In addition to the amount of firm water supply of 445,266 acre-feet per year from the Lake Buchanan and Lake Travis, LCRA is able to provide up to a maximum of 964,188 acre-feet per year from the Highland Lakes that is considered interruptible water and may only be sold on an interruptible basis subject to annual availability. LCRA currently sells firm raw water for \$126 per acre-foot per year for raw water actually used. Beginning in January 2009, the firm raw water rate will increase to \$138 per acre-foot. In addition, most customers contracting for a firm supply must pay fifty percent of the firm water rate for water that they have reserved under the contract but do not use. LCRA currently charges \$5.40 per

acre-foot for interruptible raw water. Beginning in January 2009, the interruptible raw water rate will increase to \$5.91 per acre-foot.

The total amount of LCRA's firm water supplies that is committed under contracts with customers is approximately 425,000 acre-feet per year. This commitment does not include 50,000 acre-feet per year that the LCRA Board has kept as a reserve for future use and 33,440 acre-feet per year of firm water supply for environmental needs. LCRA has also aggressively pursued, and continues to pursue, the acquisition of additional water rights within the Colorado River basin as well as the development of additional water supplies. LCRA currently owns the four downstream senior, run-of-river water rights that historically have been used for irrigation: the Gulf Coast, Lakeside, Pierce Ranch and Garwood water rights. Although such water rights are currently used for irrigation purposes, they could potentially be used for other types of needs in the future.

LCRA and San Antonio entered into a contract in 2002 that sets out LCRA's commitment to sell to the San Antonio Water System ("SAWS") up to 150,000 acre-feet of surface water per year for a term not to exceed 80 years. The contract provides for a multi-year study period to precede any delivery of water to SAWS. During that period, LCRA will conduct engineering feasibility and environmental studies and obtain necessary permits for the development and transfer of the water. The price that SAWS will pay to LCRA pursuant to the agreement will cover not only the costs that will be incurred by LCRA in developing the water that will be delivered to SAWS, but also the costs of associated with water conservation and demand reduction projects that LCRA will implement in the lower Colorado River basin. LCRA and SAWS developed a detailed study plan that was approved by the LCRA Board and SAWS. LCRA has entered into contracts with various consulting firms for assistance with the study plan implementation, and such studies are currently being conducted. Approximately \$36 million in costs for such studies are expected to be incurred by the end of calendar year 2008, and such studies are anticipated to cost a total of approximately \$49 million at completion. In the event that the project is cancelled, LCRA will be required to reimburse SAWS for 50% of the costs of the studies incurred at the time of cancellation.

Hydroelectric Facilities and Dams

LCRA continues to execute a multi-year capital program to increase the useful life, generating capacity and production efficiency of its hydroelectric facilities. As of June 30, 2008, LCRA has completed the rehabilitation of ten units at a cost of approximately \$69 million, and, based on the latest capital plan, LCRA plans to spend approximately \$21 million over Fiscal Year 2009 through Fiscal Year 2013 on the hydroelectric modernization and improvements program.

LCRA also continues to make improvements to upgrade the dams to TCEQ standards, and to provide for safer, faster and more efficient operation, particularly during flood emergencies. These improvements are primarily for replacement or repair of existing floodgates, the installation of additional floodgates and the provision of additional stabilization for the dams themselves. As of June 30, 2008, LCRA has spent approximately \$84 million on dam modernization and improvements and, based on the latest capital plan, LCRA plans to spend approximately \$37 million over Fiscal Year 2009 through Fiscal Year 2013 on such improvements.

Combined revenues from the sale of water and hydroelectric power are expected to provide funding for LCRA's water supply and hydroelectric operations. For the Fiscal Year ended June 30, 2008, revenues from these sources were approximately \$42 million.

Irrigation Canal Systems Operation

In addition to selling water for irrigation purposes, LCRA owns and operates three irrigation systems that serve portions of three counties situated on the coastal plain of South Texas. The Gulf Coast, Lakeside and Garwood Water Divisions (collectively, the "Water Divisions") serve portions of Matagorda, Wharton and Colorado Counties. When combined, the Water Divisions are capable of transporting water to a total of 91,500 acres annually.

Regional and Municipal Water and Wastewater Utility Services and Systems

Beginning in 1990, LCRA began providing water and wastewater services to various areas within and adjacent to LCRA's water service area, primarily through the acquisition by LCRA of existing municipally-owned water and wastewater treatment facilities. As of June 30, 2008, LCRA owned or operated 38 systems in Bastrop, Burnet, Colorado, Gillespie, Kimble, Lampasas, Llano, Travis and Williamson Counties. In Williamson County, LCRA operates its systems pursuant to an alliance with the Brazos River Authority. The Brazos River Authority operates the Brushy Creek Regional Wastewater System ("BCRWS"), Hutto wastewater system and Liberty Hill wastewater system, and LCRA owns, manages and finances these systems.

The BCRWS is the largest of LCRA's wastewater systems. As of June 30, 2008, LCRA had approximately \$120 million in outstanding debt issued to finance BCRWS facilities. Additional capital requirements are anticipated to include approximately \$23 million of improvements from Fiscal Year 2009 through Fiscal Year 2013. Customers of the system include the Cities of Cedar Park, Round Rock, Austin and LCRA, acting on behalf of the Brushy Creek Municipal Utility District and the Fern Bluff Municipal Utility District.

In 1994, LCRA began providing wholesale treated water services to several entities in the vicinity of the Village of Bee Cave in western Travis County. During 1999 and 2000, much of this area was consolidated into LCRA's West Travis County Regional System ("WTCRS"), a retail water and wastewater utility system that will serve a large portion of western Travis County and northern Hays County. This portion of the Austin area is experiencing significant growth and LCRA anticipates that WTCRS will continue to expand to meet the demand of the area. As of June 30, 2008, LCRA has expended approximately \$134 million on the WTCRS. Projected additional capital expenditures for WTCRS are approximately \$94 million from Fiscal Year 2009 through Fiscal Year 2013. On November 30, 2007, approximately 13% of the WTCRS water customers and 35% of the WTCRS wastewater customers appealed LCRA's multi-year retail water and wastewater rate increases to the TCEQ. LCRA can provide no assurances as to the outcome of such appeal or the effect of any such outcome on its operation of the WTCRS.

In April 2008, the LCRA Board directed staff to explore the potential of selling one or more of LCRA's water and/or wastewater systems. Any such sale would require that there are advantages to the customers of any system being sold and to LCRA's remaining customers and that LCRA realizes the economic value of any divested system. LCRA can give no assurances as to whether LCRA will ultimately sell any of its water or wastewater systems or the amount of any economic gain or loss that might result from any such divestiture.

Other Capital Improvements

The total capital expended from inception for water and wastewater utility system projects, other than the BCRWS and the WTCRS, was approximately \$138 million through June 30, 2008. LCRA expects further water and wastewater utility system expansion and improvements to occur in the next three to five years due to the growing need for regional service and LCRA's unique position as an entity with regional representation and maturing regional operating and planning experience. It is anticipated that these additional costs will be funded primarily through debt issuance during the next five years. LCRA's latest proposed five year capital plan for Water Services is approximately \$260 million, approximately \$171 million of which is expected to be financed with debt.

COMMUNITY SERVICES

LCRA created the Community Services Business Unit to provide various services that are described in the LCRA Act and other State laws to customers and communities within its service territory. These services include developing, operating and maintaining LCRA's park system, establishing and maintaining the LCRA Rangers as certified peace officers and emergency response teams, developing and operating an environmental laboratory to provide services to governmental entities and other persons in central Texas, and providing economic development services and coordination in cooperation with LCRA's customers to enhance the growth of the central Texas region. Additionally, Community Services provides services to

the other LCRA Business Units, assisting with, among other things, land and right-of-way acquisition and environmental enforcement and permitting.

While many of the various activities performed by Community Services generate fee revenue sufficient to cover the costs for performing such services, LCRA has determined that the value derived from Community Services activities will be further funded by a payment from each of the other Business Units. This payment, currently set at a level equal to three percent of the gross revenues of each Business Unit, will be utilized to support the continued ability to perform the services required by its statutory mission. LCRA estimates that the amount paid to Community Services from the other Business Units in the Fiscal Year ended June 30, 2008 was approximately \$18.2 million.

CORPORATE SERVICES

Corporate Services provides functional oversight of the Business Units and support services that are most effectively managed centrally. Support services include accounting, finance, legal, facility, technology, telecommunication, procurement, communications, customer and employee services. Approximately 28% of the total Corporate Services' costs are directly expensed to LCRA's respective Business Units as services are requested and consumed. The remainder is distributed to the Business Units through an allocation process.

FACTORS TO BE CONSIDERED IN INVESTING IN THE BONDS

As discussed more fully in this Official Statement, LCRA has made and will continue to make changes in its operations and organizational structure to meet competitive market requirements and changing market conditions. While LCRA believes that none of these changes will have a material adverse effect on its financial condition, such changes can differ in certain respects from LCRA's historical operations and will affect the manner in which it will present its financial information in the future.

Wholesale Power Agreements and Future Capital Improvements

As of the date hereof, 31 of LCRA's existing wholesale customers, including PEC and BEC, have entered into Amended and Restated Agreements with LCRA, constituting approximately 61% of the current electric load served by LCRA. Each of such agreements incorporates a "most favored nations" clause which permits a customer to adopt, within six months of notice thereof, provisions from any other form of Amended and Restated Agreement, including the recently delivered PEC Restated WPA, that LCRA executes with any other wholesale customer. The "most favored nations" clause in the Amended and Restated Agreements prevents LCRA from being able to describe the ultimate contractual relationships between itself and any of its wholesale electric customers until all of such customers have either (i) delivered an Amended and Restated Agreement or (ii) determined not to execute such an agreement.

BEC and nine other wholesale electric customers of LCRA have the right under their respective Amended and Restated Agreements, over time and subject to certain notice provisions, to a 30% Load Release. In the recently executed PEC Restated WPA, PEC has the right, over time and subject to certain notice provisions, to a 35% Load Release. LCRA anticipates that, as a result of the PEC Restated WPA, a number of customers who have executed an Amended and Restated Agreement, pursuant to the "most favored nations" provision, may elect to adopt substantive provisions of the PEC Restated WPA.

LCRA's management believes that, if all of LCRA's wholesale electric customers adopt the PEC Restated WPA and were to exercise the full 35% Load Release, LCRA will be able to comply with all bond covenants and the Policies of the LCRA Board. Additionally, while LCRA's management believes LCRA will not execute any form of Amended and Restated Agreement that will materially adversely affect LCRA and its ability to meet its obligations under the Resolution, including the payment of debt service on the Bonds, no assurances can be given as to (i) the form of Amended and Restated Agreements with other wholesale customers that may be executed and delivered in the future or (ii) other elections under the "most favored nations" provision that may be adopted by other wholesale electric customers.

LCRA's wholesale electric customers that have not executed Amended and Restated Agreements have the right to terminate their respective Original Agreements in 2016 before the maturity date of certain of

the Outstanding Parity Debt, including a portion of the Bonds. LCRA currently serves approximately 72% of its load under the Original Agreements. Additionally, LCRA is pursuing approximately \$1.8 billion of capital improvements, based on its latest capital improvement plan, over the current fiscal year and the next four fiscal years. Approximately \$1.54 billion of such improvements are expected to be financed by LCRA through the issuance of Parity Debt to be amortized over the useful life of such projects, which will extend well past 2016. Accordingly, LCRA's ability to pay debt service on the Bonds after the termination date of the Original Agreements may be dependent on the impact of the issuance of future Parity Debt related to LCRA's future capital improvements and LCRA's ability to compete in the open market. See "WHOLESALE POWER SERVICES - Wholesale Power Agreements", "FINANCIAL POLICIES, BUSINESS PLAN AND CAPITAL BUDGET - Capital Improvements and Incurrence of Additional Indebtedness" and "- Ability of LCRA to Sell Output in Restructured Market."

Wholesale Electric Customers

A substantial majority of LCRA's revenues are derived from the sale of power and energy to its wholesale electric customers. LCRA's continued success as a provider of wholesale power and energy will be dependent upon, among other things, the ability of LCRA's wholesale customers to manage their costs in a post-SB 7 competitive environment, whether or not such wholesale customers elect to participate in retail competition. None of the respective wholesale customers have notified the PUC of their intent to opt into retail competition. Although PEC informed LCRA in the Spring of 2002 that it planned to opt into retail competition at some undetermined date, to date, PEC has not publicly taken any steps to implement such plans. There can be no assurance made by LCRA that any of the wholesale customers will change their current positions regarding open competition. It cannot be determined at this time whether any or all of LCRA's wholesale customers will ultimately elect to participate in retail competition or what impact such elections would have on LCRA's planning, pricing and operations. There is a provision in each Amended and Restated Agreement which requires any wholesale electric customer who has adopted such an agreement to give LCRA at least two years notice of the effective date of any decision to opt into open competition and to designate itself or another entity acceptable to LCRA as the "Provider of Last Resort." See "WHOLESALE POWER SERVICES – Wholesale Power Agreements - *Amendment of Wholesale Power Agreements*" and "REGULATORY MATTERS - SB 7."

The impact of SB 7 on the wholesale customers' requirements obligations under the Wholesale Power Agreements cannot be determined at this time. In the event a wholesale customer elects to open its territory to competition, competition from other providers for retail customers could reduce the amount of energy such wholesale customer takes under its Wholesale Power Agreement. LCRA has not determined the impact of any such occurrences on its generation and power and energy acquisition plans and policies. SB 7 contains provisions to the effect that the legislation is not intended to impair any existing contracts or agreements.

Ability of LCRA to Sell Output in Restructured Market

LCRA has certain fixed costs associated with its Wholesale Power Services Business Unit, including debt incurred to finance the costs of electric generating units, long-term fuel and fuel transportation agreements and costs of maintenance of its electric generation assets. In the event that LCRA's wholesale electric customers elect to implement business strategies that result in such wholesale customers' requirements being less than LCRA's present load, LCRA would likely have surplus electric generation which it would then attempt to sell in the open market. Given the present interconnection limitations of ERCOT, sales of surplus power would be restricted to market participants within ERCOT. While LCRA management believes that LCRA is well positioned to compete in the open market, no assurance can be given that the market price for any surplus power would not be lower than LCRA's cost of producing such power for either short or prolonged periods of time. An overbuilding of capacity in the ERCOT region or aggressive pricing by an entity with substantial reserves could reduce energy prices such that, were LCRA required to sell its energy at market prices, LCRA would not recover all of its fixed costs. LCRA believes that in that event it would be in a position to recover its variable costs plus some margin and would have sufficient reserves to make up any fixed costs recovery shortfalls for a reasonable period of time. In the event that such condition existed for a protracted period of time, while LCRA believes that such an occurrence would be unlikely, LCRA would be required to evaluate various rate scenarios for all of its Business Units and other strategies to make up deficiencies in the recovery of fixed costs.

Regulatory Matters and Other Governmental Considerations

While Wholesale Power Services is no longer subject to PUC regulatory control, other LCRA Business Units will continue to be subject to original or appellate jurisdiction of various regulatory entities. LCRA anticipates that the appellate jurisdiction of TCEQ over certain services that are presently being provided by Water Services will continue to be exercised in a manner that will allow LCRA to obtain an acceptable coverage level for those services.

While LCRA cannot determine the likelihood of additional legislative changes to SB 7, the legislation represents a significant change in the electric utility industry in the State, and it cannot be determined whether the State Legislature will make changes to the structure embodied in SB 7 in the future. In addition, various federal legislative and regulatory actions have been and are presently being proposed, and such federal actions could result in the establishment of additional or different legal structures that would affect the operations of LCRA and its Affiliates, and any such changes in State or federal law could impose operational or financial requirements on the electric industry, including LCRA, that would differ significantly from the conditions that exist in the present planning environment.

Capital Spending and Functioning Capital Markets

As noted herein, LCRA has identified approximately \$1.8 billion of capital improvements that may be made for all Business Units from Fiscal Year 2009 through Fiscal Year 2013, excluding any capital projects of TSCorp. A portion of the required expenditures is expected to be made from internally generated funds and the balance from debt financing. LCRA's growth and service quality will be dependent in part upon the ability of LCRA to produce sufficient revenues and to access the capital markets to provide funds for these purposes. In addition, the capital budget, summarized herein, reflects only LCRA's presently identified capital needs that it believes will be required to serve its service areas with power and to implement its water operations business plan. Substantially higher capital improvement expenditures could be required of LCRA depending upon developments in the electric generation, water and wastewater services markets in the State. See "FINANCIAL POLICIES, BUSINESS PLAN AND CAPITAL BUDGET - Capital Improvements and Incurrence of Additional Indebtedness."

The credit markets have experienced substantial disruption over the course of the preceding year. There can be no assurance as to the timing or the extent of the recovery that may be made by the credit markets. If LCRA is unable to access the credit markets as a result of the disruptions that have been experienced, LCRA may have to delay certain capital improvements until such time as the capital markets rebound. The effect of such delays could result in increased costs for such improvements and a resulting delay in the receipt of revenues related to such improvements.

Rail Delivery of Coal Supply

LCRA receives coal for its coal generation facilities by rail delivery. Significant disruptions in the railroad system over a prolonged period of time have the potential to adversely affect LCRA's future coal supply such that LCRA's ability to operate its coal generation facilities could be adversely affected. See "WHOLESALE POWER SERVICES - Fuel and Fuel Transportation - *Western Coal*" and "*- Rail Transportation*."

Forward Looking Statements

The statements contained in this Official Statement, and in any other information provided by LCRA, that are not purely historical, are forward-looking statements, including statements regarding LCRA's expectations, hopes, intentions, or strategies regarding the future. While LCRA prepares various projections of operating and financial data in connection with the generation of the Business Plan, among other purposes, such projections are based on varying assumptions and are made for its internal planning purposes only and are not made for, or in connection with, the offering of securities.

The forward-looking statements herein are necessarily based on various assumptions and estimates and are inherently subject to various risks and uncertainties, including risks and uncertainties relating to the possible invalidity of the underlying assumptions and estimates and possible changes or developments in social, economic, business, industry, market, legal and regulatory circumstances and conditions and actions

taken or omitted to be taken by third parties, including customers, suppliers, business partners and competitors, and legislative, judicial and other governmental authorities and officials. Assumptions related to the foregoing involve judgments with respect to, among other things, future economic, competitive, and market conditions and future business decisions, all of which are difficult or impossible to predict accurately and, therefore, there can be no assurance that the forward-looking statements included in this Official Statement would prove to be accurate.

Readers should not place undue reliance on forward-looking statements. All forward-looking statements included in this Official Statement are based on information available to LCRA on the date hereof, and LCRA assumes no obligation to update any such forward-looking statements.

REGULATORY MATTERS

Introduction: Changes in Regulatory Environment

The electric industry in the State has experienced dramatic statutory and regulatory changes in the past several years which have had and will have significant impact on LCRA. LCRA's wholesale electric rates and services were deregulated in 1995 by the State Legislature. In order to promote wholesale electric competition, such legislation directed the PUC to adopt rules requiring all transmission system owners to make their transmission systems available for use by others at prices and terms comparable to each respective owner's use of its system for its own wholesale transactions. The PUC implemented its initial transmission open access rules in January 1997. During the 1999 legislative session, the State Legislature enacted SB 7, which provides for retail electric open competition for customers of investor-owned utilities beginning in 2002. SB 7 also continues electric transmission wholesale open access and fundamentally redefines and restructures the State electric industry. During the 2001 legislative session, the State Legislature enacted House Bill 1692, which, for the panhandle portion of the State (and outside of ERCOT), defers competition until the later of January 1, 2007 or until a utility is authorized by the PUC to implement customer choice. Because LCRA will operate wholly within ERCOT, House Bill 1692 is not relevant to the discussions in this Official Statement.

SB 7

SB 7 dramatically restructured the electric industry in the State and directly and indirectly impacts LCRA, its wholesale electric customers and TSCorp. SB 7 includes provisions that apply to municipally owned utilities ("Municipal Utilities"), investor owned utilities ("IOUs") and electric cooperatives ("Electric Coops"). SB 7 allowed retail customers of IOUs within ERCOT to choose their electric energy supplier as of January 1, 2002 as well as the retail customers of those Municipal Utilities and Electric Coops that elect, on or after that date, to participate in retail electric competition. By PUC rules, an election to opt into open competition by a Municipal Utility or an Electric Coop cannot be implemented for a six month period after such election. While certain provisions of SB 7 summarized herein do not apply directly to LCRA, those provisions are discussed for the purpose of providing information concerning the overall restructured electric utility market in the State that directly and indirectly affect LCRA.

SB 7 required all IOUs to separate retail energy service activities from regulated utility activities by September 1, 2000 and, together with LCRA, to unbundle generation, transmission/distribution and retail electric sales functions into separate companies by January 1, 2002. The services offered by such separate entities must be available to other parties on a non-discriminatory basis. As discussed in this Official Statement, pursuant to the Initial Contractual Commitment, LCRA transferred its electric transmission and transformation business, assets and properties to TSCorp, but SB 7 does not require TSCorp to be operated independently from LCRA's generation functions to the extent required of IOU affiliated companies. The PUC rules do, however, require LCRA and TSCorp to meet certain "Standards of Conduct" related to functional separation. SB 7 prohibits the PUC from adopting rules that prevent LCRA and its Affiliates, including TSCorp, from sharing officers, directors and employees or from providing goods and services to each other. See "OVERVIEW OF LCRA OPERATIONS - LCRA Transmission Services Corporation" and APPENDIX C - "LCRA TRANSMISSION SERVICES CORPORATION."

Generating assets of IOUs are now owned by "Power Generation Companies." Power Generation Companies must register with the PUC and must comply with certain rules that are intended to protect consumers, but they will otherwise be unregulated and may sell electricity at market prices. IOU owners

of transmission and/or distribution facilities are "Transmission and Distribution Utilities" and are fully regulated by the PUC. Retail sales activities are performed by new companies called "Retail Electric Providers" ("REPs") which are the only entities authorized to sell electricity to retail customers (other than Municipal Utilities and Electric Coops). REPs must register with the PUC, demonstrate financial capabilities and comply with certain consumer protection requirements. They will buy electricity from Power Generation Companies, power marketers or other parties and may resell that electricity to retail customers at any location in the State (other than within service areas of Municipal Utilities and Electric Coops that have not opened their service areas to retail competition). Transmission and Distribution Utilities, and Municipal Utilities and Electric Coops that have opted into retail competition, will be obligated to deliver the electricity to retail customers as well as wholesale buyers of electricity. The PUC is required to approve the construction of new transmission facilities and may order the construction of most new facilities to relieve transmission bottlenecks. Transmission and Distribution Utilities will be required to provide access to both their transmission and distribution systems on a non-discriminatory basis to all eligible customers. Rates for the use of the distribution systems of Municipal Utilities and Electric Coops, however, are exclusively within the jurisdiction of the governing bodies of such entities rather than the PUC. Each type of unbundled company of a formerly bundled IOU is prohibited from providing services that are provided by the other types of unbundled companies.

SB 7 also provides a number of consumer protection provisions. Every area of the State participating in retail competition will have a "Provider of Last Resort" approved by the PUC or the incumbent Municipal Utility or Electric Coop. The Provider of Last Resort must offer to sell electricity to any retail customer in its designated area at a standard rate. The Provider of Last Resort must also serve any customer whose REP has failed to provide service.

To help ensure the availability of electric generation to non-traditional suppliers, SB 7 requires IOUs to hold periodic "Capacity Auctions," supervised by the PUC, in which they must sell 15% of their power to others. Affiliated REPs are not allowed to purchase power from a related Power Generation Company. These Capacity Auctions provide resources to other parties for up to, and shall end, four years after the date that retail competition began. SB 7 also provides protection by limiting the amount of generation that any single Power Generation Company, or group of commonly owned Power Generation Companies, may own to 20% of the available generation within a "power region," i.e., ERCOT.

SB 7 preserves the PUC's regulatory authority over electric transmission facilities and open access to such transmission facilities. SB 7 provides for a transmission system operator that is independent of market participants and is responsible for directing and controlling the operation of the transmission network within ERCOT. The PUC has designated ERCOT as the "independent system operator." In addition, SB 7 directs the PUC to determine electric transmission open access rates on a 100% "postage stamp" pricing methodology. See APPENDIX C - "LCRA TRANSMISSION SERVICES CORPORATION."

Under SB 7, IOUs may recover their "stranded costs" (the net book value of certain "non-economic" assets less market value and certain "above market" purchased-power costs) and "regulatory assets," which recovery is intended to permit recovery of the difference between the amount necessary to pay for the assets required under prior electric regulation and the amount that can be collected through market based rates in the open competition market. Such stranded costs are based, in large measure, on the amount of stranded costs associated with the respective IOUs determined in the PUC's April 1998 Potentially Strandable Investment (ECOM) Report: 1998 Update (the "PUC Stranded Cost Report"). SB 7 establishes the procedure to determine the amount of IOU stranded costs and regulatory assets. Once determined, the stranded costs, if any, may be collected through a non-by-passable competition transition charge collected from the end retail electric users within the IOU's service territory as it existed on May 1, 1999, through, primarily, an additional component to the rate for the use of the retail electric distribution system delivering electricity to such end user.

IOUs may recover a certain portion of their respective stranded costs through the issuance of bonds, with a maturity not to exceed 15 years, whereby the principal, interest and reasonable costs of issuing, servicing and refinancing such bonds is secured by a qualified rate order of the PUC that creates the "competition transition charge." Neither the State nor the PUC may amend the qualified rate order in any manner that would impair the rights of the "securitized" bondholders.

SB 7 grants LCRA the ability to recover its regulatory assets and stranded costs through the issuance of bonds, however, LCRA does not anticipate issuing bonds for such purpose.

Municipal Utilities and Electric Coops are largely exempt from the requirements of SB 7. While IOUs became subject to open competition as of January 1, 2002, the governing bodies of Municipal Utilities and Electric Coops have the sole discretion to determine whether and when (after January 1, 2002) to open their service territories to retail competition. The rules of the PUC, however, require a six month period between the election to opt into retail competition and participation in such competition. However, if a Municipal Utility or Electric Coop has not voted to open its territory to retail customers, it will not be able to compete for retail electric customers at unregulated rates outside its traditional service territory. While IOUs must unbundle their generation from transmission and distribution and from retail sales activities, Municipal Utilities and Electric Coops retain the discretion to determine whether to unbundle those business activities.

The greatest potential impact on LCRA from SB 7 could result from actions of its wholesale electric customers. If LCRA's larger wholesale electric customers open their territories to retail competition, there is a potential that such customers could lose end-user customers to other REPs resulting in a reduced electric load, thus reducing the requirements served by LCRA under the existing Wholesale Power Agreements. On the other hand, if LCRA's wholesale electric customers are successful in retaining existing customers and in growing their customer base, requirements served by LCRA under the existing Wholesale Power Agreements could increase. See "FACTORS TO BE CONSIDERED IN INVESTING IN THE BONDS - Wholesale Electric Customers."

Municipal Utilities and Electric Coops will also determine the rates for use of their distribution systems after they open their territories to competition, although the PUC will determine the terms and conditions applicable to access to those systems.

SB 7 also permits Municipal Utilities and Electric Coops to recover their "stranded costs," through collection of a non-by-passable transition charge from their customers if so determined by such entities in a similar fashion to IOUs under SB 7. Unlike IOUs, the governing board of a Municipal Utility determines the amount of stranded costs to be recovered pursuant to rules and procedures established by such governing board. The stranded costs of Electric Coops are determined by their board of directors pursuant to rules and procedures established by the PUC. Municipal Utilities and Electric Coops are also permitted to recover their respective stranded costs through the issuance of bonds in a similar fashion to the IOUs.

SB 7 grants LCRA authority to provide electric transmission services statewide and provides that LCRA may operate, purchase and build transmission facilities statewide. As discussed in this Official Statement, TSCorp now performs this function on behalf of LCRA.

SB 7 also sets goals for the development of renewable generating technologies that do not burn oil and gas and do not produce air pollution. SB 7 requires that the amount of renewable energy triple from 1999 levels in the State by 2009.

In addition, the PUC is in the process of implementing a renewable energy goal required for the State to increase its renewable energy from 2,880 MW in 2009 to 5,880 MW in 2015.

Wholesale Market Design Changes

The PUC has approved wholesale electric market design changes in ERCOT that move the ERCOT wholesale power market from a zonal market to a nodal market. The new market design is expected to result in a more efficient use of generation and transmission resources as well as provide clearer price signals to generators for locating new power generation plants. Implementation of the nodal market design was originally scheduled for December 2008, but the PUC has delayed implementation pending an updated cost-benefit analysis. ERCOT will be required to: (i) operate a voluntary day-ahead energy market; (ii) directly assign all congestion rents to the resources that caused the congestion; (iii) use nodal energy prices for resources; (iv) provide information for energy trading hubs by aggregating nodes; (v) use zonal prices for loads; and (vi) provide congestion revenue rights (but not physical rights). LCRA has participated as a stakeholder by providing comments and continues to closely monitor and participate in the development of the market design. At present, LCRA is preparing for commencement of the nodal market. LCRA's management believes that LCRA is well positioned to compete in the nodal market and does not anticipate significant changes in its relationships with its wholesale electric customers as a result of the implementation of the nodal market.

Service Area

LCRA's electric system service area presently extends over all or parts of a 54-county area in central Texas. The LCRA Act limits the ability of LCRA to provide electric service outside the area directly served by LCRA's electric transmission lines and distribution system on January 1, 1975 and such other areas within the service area served by LCRA on such date which cannot receive comparable service from any other power source. LCRA may acquire, install, construct, enlarge and make additions to, and operate one or more steam generating facilities aggregating not more than 5,000 MW for the purpose of servicing the area directly served by LCRA's transmission lines and distribution system on January 1, 1975. In addition, as of September 1, 1995, LCRA may form Affiliates which may provide electric generation service at wholesale anywhere in the State. LCRA has created GenTex and LCRA Energy under this provision. See "WHOLESALE POWER SERVICES - GenTex" and "- LCRA Wholesale Energy Services Corporation." LCRA, in 1999, was permitted to provide electric transmission services statewide and, through TSCorp, is implementing a strategy to expand electric transmission services beyond LCRA's traditional electric service area. See APPENDIX C - "LCRA TRANSMISSION SERVICES CORPORATION - General" and "- TSCorp Facilities and Assets and Acquisitions/Expansions."

Proposed Federal Legislation

Many bills have been introduced in the United States House of Representatives and the United States Senate to deregulate the electric utility industry on the federal or state level. Many of the bills provide for open competition in the furnishing of electricity to all retail customers (i.e., retail wheeling). In addition, various bills have been introduced that would impact the issuance of tax-exempt bonds for electric transmission and generation facilities. No prediction can be made as to whether these bills or any future proposed federal bills will become law or, if they become law, what their final form or effect would be.

Environmental Regulation

Electric utilities are subject to numerous environmental laws and regulations administered at both the federal and State level. Over time such regulations have become more stringent as water and air quality goals have tightened, and as pollution control technologies have advanced. In addition, the growing concern that the emissions of carbon dioxide ("CO₂") and other greenhouse gases are contributing to global warming is likely to lead to comprehensive climate change legislation at the federal level.

Under the Bush Administration, several actions were taken by the United States Environmental Protection Agency (the "EPA") to further reduce emissions from the electric utility sector, while providing some degree of flexibility and certainty. In the spring of 2005, the EPA issued the Clean Air Interstate Rule ("CAIR") and the Clean Air Mercury Rule ("CAMR"). Both of these regulatory programs were challenged and such rules have been vacated by court decisions described below.

CAIR was a "cap and trade" program designed to bring states in the eastern half of the United States into compliance with the ozone and fine particulate standards by reducing nitrogen oxides ("NO_x") and sulfur dioxides ("SO₂") from electric generating units. CAIR applied to power plants in 28 "upwind" states, including Texas. The program was to be implemented in two phases, beginning in 2009 and culminated in 2015 with about 70% emission reductions. However, on July 11, 2008, in the case of *North Carolina v. EPA*, the D.C. District Court of Appeals ruled to vacate CAIR in its entirety, stating that CAIR had more than several fatal flaws. EPA has petitioned for a rehearing, but it is assumed that the next Congress will consider a legislative approach to achieving similar, if not greater, emission reductions.

CAMR was also a market based "cap and trade" program that was to be imposed on all coal fired power plants, and like CAIR was to be phased in over two periods, beginning in 2010 and culminating in 2018 with approximately 70% reductions. However, CAMR was challenged in court and, on February 2, 2008, the D.C. Circuit Court of Appeals issued a ruling that vacated CAMR and ruled that EPA must establish technology-based emission standards for mercury emissions. This court decision has resulted in uncertainty with respect to both the timing and level of mercury control requirements. Nevertheless, in all likelihood any resulting EPA rules can be expected to be more stringent and less flexible than CAMR. EPA has petitioned the U.S. Supreme Court to consider the lower court's ruling.

EPA had also attempted to provide regulatory certainty and flexibility under the new source review ("NSR") provisions of the federal Clean Air Act, but as with CAIR and CAMR the EPA has not been successful in defending their intended reforms. Under NSR, major sources, such as power plants, must upgrade their pollution controls when they undertake major modifications that also result in emission increases. The seriousness of this program came to the forefront in 1999 when the EPA launched a major enforcement initiative targeting older coal-fired electric generation plants. The enforcement initiative and subsequent settlements have had a chilling effect on the electric utility industry, as many companies hesitated to pursue improvements or perform needed maintenance on their generation assets. In an attempt to provide regulatory certainty and clarity, the EPA introduced a NSR reform package that consisted of two separate rule-making initiatives issued in late 2002 and the Fall of 2003. Although both such rules were challenged, the more controversial of the two, which is intended to better clarify those activities considered "routine maintenance, repair and replacement", was vacated by the D.C. Circuit Court of Appeals on March 17, 2006.

LCRA has taken actions that position it well with respect to NSR uncertainty as well as CAIR-like emission reductions. To this end, LCRA, along with its FPP 1 and FPP 2 partner, Austin Energy, have obtained prospective certainty and coverage from NSR, at the coal-fired Fayette Power Project, through a first of its kind innovative permitting strategy. The TCEQ Flexible Air Quality Permit (the "Flexible Permit"), which was issued in October 2002, provides authorization to undertake any physical change or change in method of operation, provided that the facility-wide emissions do not exceed applicable emission caps. Accordingly, LCRA has been able to proceed with improvements and modifications needed to ensure that the Fayette Power Project is well maintained and operated efficiently, reliably and safely. The emission caps imposed at the start of the 10-year permit term are based on historical levels, whereas, the final emission caps are based on a "best available control technology" standard. Consequently, the Flexible Permit will necessitate the installation of additional emission controls, primarily flue gas desulfurization equipment (scrubbers) to FPP 1 and FPP 2 to remove sulfur dioxide, which will reduce sulfur dioxide emission by an estimated 90 percent, at a cost to LCRA of approximately \$227.4 million. The permit also calls for the reduction of nitrogen oxide emission by 50 percent.

These levels of emission reductions will be in line with those that would have been required under the CAIR program by phase II in 2015. Moreover, the installation of scrubbers on FPP Units 1 and 2 will ensure that LCRA continues to have excess SO₂ allowances, which can be marketed.

Although it is now uncertain as to what the EPA or Congress will do with respect to mercury regulations, as well as requirements to further reduce sulfur dioxide and nitrogen oxides emissions, it is certainly expected that further and more stringent regulations are on the horizon. With respect to mercury, some level of reductions are expected as a "co-benefit" associated with the installation of the scrubbers on FPP1 and FPP2. In addition, LCRA has teamed up with several partners and the United States Department of Energy to field test advanced mercury control technologies. The results of these projects, in addition to other research and development underway, will help LCRA in evaluating and selecting the appropriate mercury control strategy.

In anticipation of the possible future adoption of a federal program to address greenhouse gas emissions, LCRA has performed detailed analyses of the impact of proposed legislation on its facilities. While there is much uncertainty as to how any such program may ultimately be designed and implemented, LCRA believes that it is factoring the best available information into its generation resource decisions.

The Federal Clean Air Act Background. In 1990, legislation was signed into law that significantly amended the Clean Air Act (the "1990 Amendments"). Among other requirements, the 1990 Amendments addressed acid rain deposition through the reduction of sulfur dioxide and nitrogen oxide emissions from electric utility power plants, particularly those fueled by coal. In an innovative approach to pollution control, sulfur dioxide emissions were limited by means of a market-based emission cap and trade program, which was implemented in two phases. LCRA units, in particular the three coal-fired units at the Fayette Power Project, were subject to Phase II of this program, which went into effect in year 2000. Under the program, all three units have received sufficient sulfur dioxide allowances to sustain current operating requirements. LCRA is able to maintain low sulfur dioxide emissions by burning low sulfur western coal in all three Fayette Power Project units and by employing a sulfur dioxide scrubber on FPP 3. And as noted above, the Flexible Permit will necessitate the employment of scrubbers on FPP Units 1 and 2, further freeing up excess sulfur dioxide allowances.

The 1990 Amendments also required coal units to reduce nitrogen oxide emissions. As with the sulfur dioxide program, the nitrogen oxide program consists of a two-phase strategy, with the first set units achieving compliance in 1996 and the second in 2000. The Fayette Power Project units are covered under Phase II, however, LCRA elected to comply early with the Phase I nitrogen oxide limitations. Although the early election

is accompanied with an extension of the more stringent Phase II limitation until January 1, 2008, this is not an issue for LCRA because the nitrogen oxide emissions from all three units at the Fayette Power Project are currently well below both the Phase I and Phase II limitations. Furthermore, pursuant to both State regulations and the Flexible Permit, nitrogen oxide emissions from all LCRA fossil fuel plants have been significantly reduced.

Ambient Air Quality Standards. The EPA has established national air quality standards for six regulated pollutants: ozone, lead, carbon monoxide, sulfur dioxide, nitrogen dioxide, and particulate matter. When a pollutant concentration in an area exceeds a standard, the area is classified as "nonattainment" for that pollutant. A nonattainment designation then triggers a process by which the affected state must develop and implement a plan to improve air quality and "attain" compliance with the appropriate standard. This so called State Implementation Plan or "SIP" entails enforceable control measures and timeframes.

Of these six pollutants, large urban areas have had the greatest difficulty achieving the ozone standard. This challenge was compounded in July of 1997, when the EPA adopted a revised and more stringent ozone standard along with a new standard for fine particulates. The tighter ozone standard is often referred to as the 8-hour standard because it is based on an 8-hour average and is intended to protect public health against longer exposure. Both the 8-hour ozone and fine particulate standard were challenged and were ultimately upheld by the Supreme Court in February of 2001.

The EPA has again revised the 8-hour ozone standard. On March 12, 2008, the EPA issued a final rule that tightens the 8-hour ozone standard from its current level of 0.08 parts per million ("ppm") to 0.075 ppm. This new standard is likely to result in a significant increase in the number of nonattainment areas and will present a formidable challenge to the states as they struggle to bring these areas back into compliance.

Under the current 8-hour ozone standard, there are three areas in the State classified as nonattainment: Houston/Galveston, Beaumont/Port Arthur, and Dallas/Fort Worth. Although the San Antonio has also exceeded the 8-hour standard, it has received a nonattainment deferred designation because it has voluntarily entered into an Early Action Compact ("EAC") with the TCEQ. Under an EAC, air quality improvements will be accelerated and the nonattainment designation will be deferred as long as the voluntary actions are successfully implemented. The Austin area has also entered into an EAC, however, the area is currently in compliance with the existing 8-hour standard. Under the new standard, it is highly likely that both the San Antonio and Austin area will be out of compliance or nonattainment. The nonattainment determinations will be made by the EPA in 2010 and the states will then have three years to develop a state implementation plan, which will set forth those actions that will be taken to bring the areas back into compliance. This plan may result in further emission reduction requirements for power plants.

In an effort to improve the air quality in both existing and impending nonattainment areas, the State had implemented two regional programs targeted at reducing statewide nitrogen oxide emissions from power plants. Nitrogen oxide emissions are targeted in that these compounds react with volatile organic compounds in the presence of sunlight to form ground level ozone. The first program, which was part of SB 7, required that "grandfathered" power plants, i.e., facilities that were constructed prior to the 1971 Texas Clean Air Act, obtain a Texas Air Permit and reduce nitrogen oxide emissions by approximately 50%. LCRA's Gideon and Ferguson plants are "grandfathered." Accordingly, permit applications were submitted for both of these facilities on September 1, 2000, and the requisite nitrogen oxide reductions were made in calendar year 2003. Furthermore, the reductions at the Gideon plant were made two years ahead of schedule, as part of a commitment to offset all nitrogen oxide emissions associated with the GenTex Lost Pines 1 Power Project. See "REGULATORY MATTERS-SB 7."

The second program was implemented on April 19, 2000, when the TCEQ adopted a regional nitrogen oxide reduction rule affecting permitted power plants in the attainment counties in the eastern half of the State. The regional rule, as with the grandfathered provisions of SB 7, called for an approximate 50% reduction of nitrogen oxide from permitted power plants. Fayette Power Project achieved compliance with this rule in 2005 by undertaking boiler/combustion modifications at a cost of approximately \$15 million per unit. The modifications resulted in nitrogen oxide reductions well below required levels, which would have positioned LCRA well for the aforementioned CAIR program.

Federal Energy Regulatory Commission Regulation

LCRA submits various reports to the Federal Energy Regulatory Commission ("FERC") and substantially conforms to the FERC Uniform System of Accounts in maintaining its books of account. The dams owned by LCRA have not been subject to licensing by the FERC or its predecessor agencies under the Federal Power Act. Mansfield Dam is exempt by reason of an act of Congress. With respect to the other dams, the FERC's predecessor agencies determined in 1927 and 1949 that those portions of the Colorado River upon which such dams are located are not navigable and that the facilities do not affect the interests of interstate commerce. As recently as 1989, the FERC confirmed that LCRA dams and related facilities were not required to be licensed. Historically, electric utilities operating in the State have not had any interstate connections other than in certain emergency situations and hence IOUs' and LCRA's dams and other electric facilities have not been subject to the FERC regulatory or licensing requirements on the basis of such interstate connections. Over the past several years, various efforts have been made to provide some interstate connections. These efforts have resulted in protracted judicial and administrative proceedings involving ERCOT members. The FERC has issued orders, which, among other things, permit the ERCOT members to avoid federal regulation of rates as the result of the ordered interconnections with another interstate connected utility. However, the question of the FERC's ability to require licensing of LCRA's dams as a result of such interstate connections is unresolved.

Reliability Compliance

The federal Energy Policy Act of 2005 (the "2005 Energy Act") significantly changed the electric regulatory climate in North America. The 2005 Energy Act requires all electric utilities in the United States to comply with reliability standards promulgated and enforced by the North American Electric Reliability Corporation ("NERC"), under the supervision of FERC. Such mandatory and enforceable reliability standards include the ability to assess civil penalties for violations of such standards. The 2005 Energy Act also allows NERC to delegate enforcement authority to a regional entity, subject to FERC approval, and NERC has designated the Texas Regional Entity (a division of ERCOT) as the regional enforcement entity within ERCOT.

LCRA is committed to the establishment and maintenance of a program to comply with and exceed the NERC reliability standards. This will require an ongoing effort to monitor the reliability standards, develop procedures to provide for implementation and install processes to assure continued compliance. To accomplish this, LCRA has appointed a generation NERC compliance manager and established compliance organizations within Wholesale Power Services. In addition, an oversight group composed of staff of LCRA, including certain members of executive management, will provide management guidance and support to the compliance efforts. LCRA believes it is in material compliance with current NERC reliability standards.

LITIGATION

There are various other lawsuits in which LCRA is involved. LCRA's management, including its General Counsel, estimates that the potential claims against LCRA not covered by insurance resulting from such litigation would not materially affect LCRA's financial condition or its obligations with respect to the Bonds, its bondholders or other outstanding obligations.

LEGAL MATTERS

Legal matters incident to the authorization, issuance, sale and delivery of the Bonds are subject to the approval of the Attorney General of the State and of McCall, Parkhurst & Horton L.L.P., Dallas and Austin, Texas, Bond Counsel ("Bond Counsel"). Other legal matters will be passed upon for LCRA by McCall, Parkhurst & Horton L.L.P., Securities Counsel to LCRA and by LCRA's General Counsel. In connection with the transactions described in this Official Statement, McCall, Parkhurst & Horton L.L.P. represents LCRA. A portion of the fee to be paid to McCall, Parkhurst & Horton L.L.P. is contingent upon the sale and delivery of the Bonds. Certain legal matters in connection with the issuance of the Bonds will be passed upon for the Underwriters by Hawkins Delafield & Wood LLP, Sacramento, California, Counsel to the Underwriters. McCall, Parkhurst & Horton L.L.P., as Bond Counsel and Securities Counsel, has not reviewed LCRA and TSCorp's respective management discussion and analysis and the audited financial information contained in APPENDICES B and D to this Official Statement.

The various legal opinions to be delivered concurrently with the delivery of the Bonds express the professional judgment of the attorneys rendering the opinions as to the legal issues explicitly addressed therein. In rendering a legal opinion, the attorney does not become an insurer or guarantor of the expression of professional judgment, of the transaction opined upon, or of the future performance of the parties to the transaction. Nor does the rendering of an opinion guarantee the outcome of any legal dispute that may arise out of the transaction.

TAX MATTERS

Opinion

On the date of initial delivery of the Bonds, McCall, Parkhurst & Horton L.L.P., Austin and Dallas, Texas, Bond Counsel, will render its opinions that, in accordance with statutes, regulations, published rulings and court decisions existing on the date thereof ("Existing Law"), (1) interest on the Bonds for federal income tax purposes will be excludable from the "gross income" of the owners thereof and (2) the Bonds will not be treated as "specified private activity bonds" the interest on which would be included as an alternative minimum tax preference item under section 57(a)(5) of the Internal Revenue Code of 1986, as amended (the "Code"). Except as stated above, Bond Counsel will express no opinion as to any other federal, state or local tax consequences of the purchase, ownership or disposition of the Bonds. See APPENDIX E - "FORM OF OPINION OF BOND COUNSEL."

In rendering its opinions, Bond Counsel will rely upon (a) certain information and representations of LCRA, including information and representations contained in LCRA's federal tax certificate, and (b) covenants of LCRA contained in the documents relating to the Bonds regarding certain matters, including arbitrage and the use of the proceeds of the Bonds and the Refunded Obligations and the property financed or refinanced therewith. Failure by LCRA to observe the aforementioned representations or covenants, could cause the interest on the Bonds to become taxable retroactively to the date of issuance.

The Code and the regulations promulgated thereunder contain a number of requirements that must be satisfied subsequent to the issuance of the Bonds in order for interest on the Bonds to be, and to remain, excludable from gross income for federal income tax purposes. Failure to comply with such requirements may cause interest on the Bonds to be included in gross income retroactively to the date of issuance of the Bonds. The opinion of Bond Counsel is conditioned on compliance by LCRA with such requirements, and Bond Counsel has not been retained to monitor compliance with these requirements subsequent to the issuance of the Bonds.

Bond Counsel's opinion represents its legal judgment based upon its review of Existing Law and the reliance on the aforementioned information, representations and covenants. Bond Counsel's opinion is not a guarantee of a result. Existing Law is subject to change by Congress and to subsequent judicial and administrative interpretation by the courts and the Department of the Treasury. There can be no assurance that Existing Law or the interpretation thereof will not be changed in a manner which would adversely affect the tax treatment of the purchase, ownership or disposition of the Bonds. See "REGULATORY MATTERS - Proposed Federal Legislation."

A ruling was not sought from the Internal Revenue Service by LCRA with respect to the Bonds or the property financed or refinanced with the proceeds of the Bonds or the Refunded Obligations. No assurances can be given as to whether the Internal Revenue Service will commence an audit of the Bonds, or as to whether the Internal Revenue Service would agree with the opinion of Bond Counsel. If an Internal Revenue Service audit is commenced, under current procedures the Internal Revenue Service is likely to treat LCRA as the taxpayer and the Bondowners may have no right to participate in such procedure. No additional interest will be paid upon any determination of taxability.

Federal Income Tax Accounting Treatment of Original Issue Discount

The Underwriters have represented that the initial public offering price to be paid for one or more maturities of the Bonds is less than the principal amount thereof (the "OID Bonds"). The difference between (i) the "stated redemption price at maturity" of each OID Bond, and (ii) the initial offering price to the public of such OID Bond constitutes original issue discount. The "stated redemption price at maturity" means the sum of all payments to be made on the Bonds less the amount of all periodic interest payments. Periodic interest payments are payments which are made during equal accrual periods (or during any unequal period if it is the initial or final period) and which are made during accrual periods which do not exceed one year.

Under Existing Law, any owner who has purchased such OID Bond in the initial public offering is entitled to exclude from gross income (as defined in section 61 of the Code) an amount of income with respect to such OID Bond equal to that portion of the amount of such original issue discount allocable to the accrual period. For a discussion of certain collateral federal tax consequences, see discussion set forth below.

In the event of the redemption, sale or other taxable disposition of such OID Bond prior to stated maturity, however, the amount realized by such owner in excess of the basis of such OID Bond in the hands of such owner (adjusted upward by the portion of the original issue discount allocable to the period for which such OID Bond was held by such initial owner) is includable in gross income.

Under Existing Law, the original issue discount on each OID Bond is accrued daily to the stated maturity thereof (in amounts calculated as described below for each six-month period ending on the date before the semiannual anniversary dates of the date of the Bonds and ratably within each such six-month period) and the accrued amount is added to an initial owner's basis for such OID Bond for purposes of determining the amount of gain or loss recognized by such owner upon the redemption, sale or other disposition thereof. The amount to be added to basis for each accrual period is equal to (a) the sum of the issue price and the amount of original issue discount accrued in prior periods multiplied by the yield to stated maturity (determined on the basis of compounding at the close of each accrual period and properly adjusted for the length of the accrual period) less (b) the amounts payable as current interest during such accrual period on such OID Bond.

The federal income tax consequences of the purchase, ownership, redemption, sale or other disposition of OID Bonds which are not purchased in the initial offering at the initial offering price may be determined according to rules which differ from those described above. All owners of OID Bonds should consult their own tax advisors with respect to the determination for federal, state and local income tax purposes of the treatment of interest accrued upon redemption, sale or other disposition of such OID Bonds and with respect to the federal, state, local and foreign tax consequences of the purchase, ownership, redemption, sale or other disposition of such OID Bonds.

Collateral Federal Income Tax Consequences

The following discussion is a summary of certain collateral federal income tax consequences resulting from the purchase, ownership or disposition of the Bonds. This discussion is based on Existing Law, which is subject to change or modification, retroactively.

The following discussion is applicable to investors, other than those who are subject to special provisions of the Code, such as financial institutions, property and casualty insurance companies, life insurance companies, individual recipients of Social Security or Railroad Retirement benefits, individuals allowed an earned income credit, certain S corporations with accumulated earnings and profits and excess passive investment income, foreign corporations subject to the branch profits tax and taxpayers who may be deemed to have incurred or continued indebtedness to purchase tax-exempt obligations.

THE DISCUSSION CONTAINED HEREIN MAY NOT BE EXHAUSTIVE. INVESTORS, INCLUDING THOSE WHO ARE SUBJECT TO SPECIAL PROVISIONS OF THE CODE, SHOULD CONSULT THEIR OWN TAX ADVISORS AS TO THE TAX TREATMENT WHICH MAY BE ANTICIPATED TO RESULT FROM THE PURCHASE, OWNERSHIP AND DISPOSITION OF TAX-EXEMPT OBLIGATIONS BEFORE DETERMINING WHETHER TO PURCHASE THE BONDS.

Interest on the Bonds will be includable as an adjustment for "adjusted current earnings" to calculate the alternative minimum tax imposed on corporations by section 55 of the Code. Section 55 of the Code imposes a tax equal to 20 percent for corporations, or 26 percent for noncorporate taxpayers (28 percent for taxable income exceeding \$175,000), of the taxpayer's "alternative minimum taxable income," if the amount of such alternative minimum tax is greater than the taxpayer's regular income tax for the taxable year.

Under section 6012 of the Code, owners of tax-exempt obligations, such as the Bonds, may be required to disclose interest received or accrued during each taxable year on their returns of federal income taxation.

Section 1276 of the Code provides for ordinary income tax treatment of gain recognized upon the disposition of a tax-exempt obligation, such as the Bonds, if such obligation was acquired at a "market discount" and if the

fixed maturity of such obligation is equal to, or exceeds, one year from the date of issue. Such treatment applies to "market discount bonds" to the extent such gain does not exceed the accrued market discount of such bonds; although for this purpose, a de minimis amount of market discount is ignored. A "market discount bond" is one which is acquired by the owner at a purchase price which is less than the stated redemption price at maturity or, in the case of an obligation issued at an original issue discount, the "revised issue price" (i.e., the issue price plus accrued original issue discount). The "accrued market discount" is the amount which bears the same ratio to the market discount as the number of days during which the owner holds the obligation bears to the number of days between the acquisition date and the final maturity date.

State, Local and Foreign Taxes

Investors should consult their own tax advisors concerning the tax implications of the purchase, ownership or disposition of the Bonds under applicable state or local laws. Foreign investors should also consult their own tax advisors regarding the tax consequences unique to investors who are not United States persons.

CONTINUING DISCLOSURE OF INFORMATION

Annual Reports

LCRA will provide updated financial information and operating data to certain information vendors annually. The information to be updated includes all quantitative financial information and operating data with respect to LCRA of the general type included in this Official Statement and in APPENDIX B - "MANAGEMENT'S DISCUSSION AND ANALYSIS AND AUDITED FINANCIAL STATEMENTS FOR THE FISCAL YEARS ENDED JUNE 30, 2008 AND 2007 AND SUPPLEMENTAL CONSOLIDATING SCHEDULES FOR THE FISCAL YEARS ENDED JUNE 30, 2008 AND 2007," and more particularly as described in APPENDIX G hereto. In addition, the LCRA Revenue Financing Program special purpose financial statements, which include LCRA and each Obligated Affiliate, will be prepared in accordance with the requirements of the Master Resolution. LCRA will update and provide this information within six months after the end of each Fiscal Year. LCRA will provide the updated information to each nationally recognized municipal securities information repository ("NRMSIR") and to any state information depository ("SID") that is designated by the State and approved by the staff of the United States Securities and Exchange Commission (the "SEC").

LCRA may provide updated information in full text or may incorporate by reference certain other publicly available documents, as permitted by SEC Rule 15c2-12 (the "Rule"). The updated information will include audited financial statements, if LCRA commissions an audit and it is completed by the required time. If audited financial statements are not available by the required time, LCRA will provide unaudited financial statements by the required time, and will provide audited financial statements when and if an audit report becomes available. Any such financial statements will be prepared in accordance with the accounting principles described in APPENDIX B or such other accounting principles as LCRA may be required to employ from time to time pursuant to State law or regulation.

LCRA's current Fiscal Year end is June 30. Accordingly, it must provide updated information by the last day of December in each year, unless LCRA changes its Fiscal Year. If LCRA changes its Fiscal Year, it will notify each NRMSIR and any SID of the change.

Material Event Notices

LCRA will also provide timely notices of certain events to certain information vendors. LCRA will provide notice of any of the following events with respect to the Bonds, if such event is material to a decision to purchase or sell Bonds: (1) principal and interest payment delinquencies; (2) non-payment related defaults; (3) unscheduled draws on debt service reserves reflecting financial difficulties; (4) unscheduled draws on credit enhancements reflecting financial difficulties; (5) substitution of credit or liquidity providers, or their failure to perform; (6) adverse tax opinions or events affecting the tax-exempt status of the Bonds; (7) modifications to rights of Owners of the Bonds; (8) Bond calls; (9) defeasances; (10) release, substitution, or sale of property securing repayment of the Bonds; and (11) rating changes. In addition, LCRA will provide timely notice of any failure by LCRA to provide information, data, or financial statements in accordance with its agreement described above under "CONTINUING DISCLOSURE OF INFORMATION - Annual Reports." LCRA will provide each notice described in this paragraph to any SID and to either each NRMSIR or the Municipal Securities Rulemaking Board ("MSRB").

Availability of Information from NRMSIRs and SID

LCRA has agreed to provide the foregoing information only to NRMSIRs (or the MSRB, as appropriate) and any SID. The information will be available to Owners of Bonds only if the Owners comply with the procedures and pay the charges established by such information vendors or obtain the information through securities brokers who do so.

The Municipal Advisory Council of Texas (the "MAC") has been designated by the State, and been approved by the SEC, as a qualified SID. The address of the Municipal Advisory Council is 600 West 8th Street, Post Office Box 2177, Austin, Texas 78768-2177, and its telephone number is (512) 476-6947.

The MAC has also received SEC approval to operate, and has begun to operate, a "central post office" for information filings made by municipal issuers, such as LCRA, which then transmits the filed information to the NRMSIRs and the appropriate SID. This central post office can be accessed and utilized at www.DisclosureUSA.com ("DisclosureUSA"). LCRA may elect to utilize DisclosureUSA for the filing of information relating to the Bonds.

Limitations and Amendments

LCRA has agreed to update information and to provide notices of material events only as described above. LCRA has not agreed to provide other information that may be relevant or material to a complete presentation of its financial results of operations, condition, or prospects or agreed to update any information that is provided, except as described above. LCRA makes no representation or warranty concerning such information or concerning its usefulness to a decision to invest in or sell Bonds at any future date. LCRA disclaims any contractual or tort liability for damages resulting in whole or in part from any breach of its continuing disclosure agreement or from any statement made pursuant to its agreement, although Owners and beneficial owners of Bonds may seek a writ of mandamus to compel LCRA to comply with its respective agreement.

This continuing disclosure agreement may be amended by LCRA from time to time to adapt to changed circumstances that arise from a change in legal requirements, a change in law, or a change in the identity, nature, status, or type of operations of LCRA, but only if (1) the provisions, as so amended, would have permitted an underwriter to purchase or sell Bonds in the primary offering of the Bonds in compliance with the Rule, taking into account any amendments or interpretations of the Rule since such offering as well as such changed circumstances and (2) either (a) the registered Owners of a majority in aggregate principal amount (or any greater amount required by any other provision of the Resolution that authorizes such an amendment) of the outstanding Bonds consent to such amendment or (b) a person that is unaffiliated with LCRA (such as nationally recognized bond counsel) determined that such amendment will not materially impair the interest of the registered Owners and beneficial Owners of the Bonds. LCRA may also amend or repeal the provisions of this continuing disclosure agreement if the SEC amends or repeals the applicable provision of the Rule or a court of final jurisdiction enters judgment that such provisions of the Rule are invalid, but only if and to the extent that the provisions of this sentence would not prevent an underwriter from lawfully purchasing or selling Bonds in the primary offering of the Bonds.

Compliance with Prior Undertakings

In the past five years, LCRA is in compliance with its continuing disclosure agreements.

RATINGS

Moody's Investors Service ("Moody's"), Standard & Poor's Ratings Services ("S&P") and Fitch Ratings ("Fitch") have assigned their ratings of "A1," "A" and "A+," respectively, to the Bonds. An explanation of the significance of such ratings may be obtained from the company furnishing the rating. The ratings reflect only the respective views of such organizations, and LCRA makes no representation as to the appropriateness of the ratings. There is no assurance that any of the ratings will continue for any given period of time or that they will not be revised or withdrawn entirely by one or more rating companies, if in the judgment of such companies, circumstances so warrant. Any downward revision or withdrawal of such ratings, or any of them, may have an adverse effect on the market price of the Bonds.

UNDERWRITING

The Underwriters have jointly and severally agreed, subject to certain conditions, to purchase the Bonds from LCRA at an aggregate discount from the initial offering prices of the Bonds, set forth on the inside cover page hereof, equal to approximately 0.63282% of the par amount of such Bonds. The Underwriters will be obligated to purchase all such Bonds if any are purchased. The Bonds may be offered and sold to certain dealers at prices lower than public offering prices and the public offering prices may be changed from time to time.

J.P. Morgan Securities Inc., one of the underwriters of the Bonds, has entered into an agreement (the "Distribution Agreement") with UBS Financial Services Inc. for the retail distribution of certain municipal securities offerings at the original issue prices. Pursuant to the Distribution Agreement, J.P. Morgan Securities Inc. will share a portion of its underwriting compensation with respect to the Bonds with UBS Financial Services Inc.

LEGAL INVESTMENTS IN TEXAS

The Act provides that the Bonds are legal and authorized investments for individuals, partnerships, profit and nonprofit corporations, banks, savings banks, trust companies, building and loan associations, savings and loan associations, insurance companies, fiduciaries, trustees, guardians and for the sinking funds of cities, towns, villages, counties, school districts and other political corporations and subdivisions of the State.

The Bonds are also eligible to secure deposits of public funds of the State, its agencies and political subdivisions, and are legal security for those deposits to the extent of their market value. The Texas Public Funds Investment Act, Chapter 2256, Texas Government Code, as amended, provides that a city, county or school district may invest in the Bonds, provided the Bonds have received a rating of not less than "A" or its equivalent from a nationally recognized investment rating firm. No investigation has been made of other laws, regulations or investment criteria which might limit the ability of such institutions or entities to invest in the Bonds, or which might limit the suitability of the Bonds to secure the funds of such entities. No review by LCRA has been made of the laws in other states to determine whether the Bonds are legal investments for various institutions in those states.

FINANCIAL ADVISOR

OBP Muni LLC is employed as Financial Advisor to LCRA in connection with the issuance of the Bonds. The Financial Advisor's fee for services rendered with respect to the sale of the Bonds is contingent upon the issuance and delivery of the Bonds.

MISCELLANEOUS

The financial data and other information contained herein have been obtained primarily from LCRA's records, audited financial statements and other sources which are believed to be reliable. There is no guarantee that any of the assumptions or estimates contained herein will be realized. All of the summaries of the statutes, documents and resolutions contained in this Official Statement are made subject to all of the provisions of such statutes, documents and resolutions. These summaries do not purport to be complete statements of such provisions and reference is made to such statutes, documents and resolutions for further information. Reference is made to original documents in all respects. The authorization, agreements and covenants of LCRA are set forth in the Resolution and neither this Official Statement nor any advertisement of the Bonds is to be construed as a contract with the Owners of the Bonds. Any statements made in this Official Statement involving matters of opinion or of estimates, whether or not expressly so identified, are intended merely as such and not as representations of fact.

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APPENDIX A

SUMMARY OF CERTAIN PROVISIONS OF THE RESOLUTION

The information set forth below is a summary of selected provisions of the Master Resolution and the Twenty-Eighth Supplement (collectively, the "Resolution"). The summary of the Resolution contained herein does not purport to be complete and is qualified in its entirety by reference to the Resolution. Copies of the Resolution are available from LCRA.

Definitions

The following definitions are used in this summary of the Resolution which follows or are otherwise used in the Official Statement.

"Accountant" or "Certified Public Accountant" mean a certified public accountant or firm or corporation of certified public accountants, selected by the Board, which in the case of an individual is not a director, officer, or employee of LCRA, and in the case of a firm or corporation does not have a partner, director, officer, or employee who is a director, officer, or employee of LCRA.

"Accounting Principles" means "Generally Accepted Accounting Principles" in the United States, which are promulgated by the Government Accounting Standards Board ("GASB"), the Financial Accounting Standards Board ("FASB"), and, when applicable, other authoritative financial and accounting rule-making bodies and regulatory entities.

"Acts" means the LCRA Act, Chapter 152, Texas Water Code, Chapter 1371, Texas Government Code and other applicable law, together with all amendments thereto.

"Affiliate" of LCRA means a nonprofit corporation or other entity created as an instrumentality of LCRA under State law over which the Board exercises substantial control. For purposes of this definition, "control" means those powers to direct or approve the policies or actions of an Affiliate undertaken by the Board in the Master Resolution; and the terms "controlling" and "controlled" have meanings correlative to the foregoing.

"Annual Debt Service Requirements" means, for any Fiscal Year, (i) the principal of, premium, if any, and interest on all Parity Debt coming due at Maturity or Stated Maturity (or that could come due on demand of the Owner thereof other than by acceleration or other demand conditioned upon default by LCRA on such Parity Debt, or be payable in respect of any required purchase of such Parity Debt by LCRA) and (ii) all payments required to be made by LCRA under each Credit Agreement (net of any credits as provided in (7) immediately below) in such Fiscal Year, and, for such purposes, any one or more of the following rules shall apply at the election of LCRA; provided, however, such rules shall not be applied in a manner which would result in Annual Debt Service Requirements for any Fiscal Year in which a payment with respect to Outstanding Parity Debt is to be made is less than the amount required to be paid in such Fiscal Year with respect to such Parity Debt:

(1) Committed Take Out. If LCRA has entered into a Credit Agreement constituting a binding commitment within normal commercial practice, from any bank, savings and loan association, insurance company, or similar institution to discharge any of its Funded Debt at its Stated Maturity (or, if due on demand, at any date on which demand may be made) or to purchase any of its Funded Debt at any date on which such Debt is subject to required purchase, all under arrangements whereby LCRA's obligation to repay the amounts advanced for such discharge or purchase constitutes Funded Debt, then the portion of the Funded Debt committed to be discharged or purchased shall be excluded from such calculation and the principal of and interest on the Funded Debt incurred for such discharge or purchase that would be due in the Fiscal Year for which the calculation is being made, if incurred at the Stated Maturity or purchase date of the Funded Debt to be discharged or purchased, shall be added to such calculation, and the remaining provisions of this definition shall be applied to such added Funded Debt;

(2) Balloon Debt. If the principal (including the accretion of interest resulting from original issue discount or compounding of interest) of any series or issue of Funded Debt due (or payable in respect of any

required purchase of such Funded Debt by LCRA) in any Fiscal Year either is equal to at least 25% of the total principal (including the accretion of interest resulting from original issue discount or compounding of interest) of such Funded Debt or exceeds by more than 50% the greatest amount of principal of such series or issue of Funded Debt due in any preceding or succeeding Fiscal Year (such principal due in such Fiscal Year for such series or issue of Funded Debt being referred to herein as "Balloon Debt"), the amount of principal of such Balloon Debt taken into account during any Fiscal Year shall be equal to the debt service calculated using the original principal amount of such Balloon Debt amortized over the Term of Issue on a level debt service basis at an assumed interest rate equal to the rate borne by such Balloon Debt on the date of calculation;

(3) Consent Sinking Fund. In the case of Balloon Debt (as defined in clause (2) above), if an Authorized Representative shall deliver to the Board an Officer's Certificate providing for the retirement of (and the instrument creating such Balloon Debt shall permit the retirement of), or for the accumulation of a sinking fund for (and the instrument creating such Balloon Debt shall permit the accumulation of a sinking fund for), such Balloon Debt according to a fixed schedule stated in such Officer's Certificate ending on or before the Fiscal Year in which such principal (and premium, if any) is due, then the principal of (and, in the case of retirement, or to the extent provided for by the sinking fund accumulation, the premium, if any, and interest and other payments due on) such Balloon Debt shall be computed as if the same were due in accordance with such schedule, provided that this clause (3) shall apply only to Balloon Debt for which the installments previously scheduled have been paid or deposited to the sinking fund established with respect to such Debt on or before the times required by such schedule; and provided further that this clause (3) shall not apply where LCRA has elected to apply the rule set forth in clause (2) above;

(4) Prepaid Debt. Principal of and interest on Parity Debt, or portions thereof, shall not be included in the computation of the Annual Debt Service Requirements for any Fiscal Year for which such principal or interest are payable from funds on deposit or set aside in trust for the payment thereof at the time of such calculations (including, without limitation, capitalized interest and accrued interest so deposited or set aside in trust) with a financial institution acting as fiduciary with respect to the payment of such Parity Debt;

(5) Variable Rate. As to any Parity Debt that bears interest at a variable interest rate which cannot be ascertained at the time of calculation of the Annual Debt Service Requirement, at the election of LCRA, either (1) an interest rate equal to the average rate borne by such Parity Debt (or by comparable debt in the event that such Parity Debt has not been outstanding during the preceding 24 months) for any 24 month period ending within 30 days prior to the date of calculation, (2) if the Parity Debt bears interest at tax-exempt rates, an interest rate equal to the 30-year Tax-Exempt Revenue Bond Index (as most recently published in The Bond Buyer), shall be presumed to apply for all future dates, unless such index is no longer published in The Bond Buyer, in which case an index of tax-exempt revenue bonds with maturities of at least 20 years which is published in a newspaper or journal with national circulation may be used for this purpose, or (3) that interest rate which, in the judgment of LCRA's Chief Financial Officer, based, to the extent possible, upon an accepted market index which corresponds with the provisions of the subject Parity Debt, is the average rate anticipated to be in effect with respect to such Parity Debt;

(6) Commercial Paper. With respect to any Parity Debt issued in the form of commercial paper with maturities not exceeding 270 days, the interest on such Parity Debt shall be calculated in the manner provided in clause (5) of this definition and the maturity schedule shall be calculated in the manner provided in clause (2) of this definition; and

(7) Credit Agreement Payments. If LCRA has entered into a Credit Agreement in connection with an issue of Parity Debt, payments due under the Credit Agreement (other than payments for fees and expenses) from either LCRA or the Credit Provider shall be included in such calculation, except to the extent that the payments are already taken into account under clauses (1) through (6) immediately above and any payments otherwise included under clauses (1) through (6) immediately above which are to be replaced by payments under a Credit Agreement, from either LCRA or the Credit Provider, shall be excluded from such calculation.

"Authorized Representative" means one or more of the following officers or employees of LCRA, acting in concert or individually, to wit: the General Manager, the Deputy General Manager, the Chief Financial Officer, the Treasurer, or any officer or employee of LCRA appointed as such by resolution of the Board.

"Board" means the Board of Directors of LCRA.

"Bond Counsel" means an attorney or firm of attorneys of national reputation experienced in matters of State and federal income tax law relating to the issuance of municipal bonds, as selected by LCRA.

"Bonds" means the Lower Colorado River Authority Refunding Revenue Bonds, Series 2008A.

"Chief Financial Officer" means the chief financial officer of LCRA having the principal duties and responsibilities to account for all funds and property of LCRA and the maintenance of books, accounts, and records pertaining to the financial transactions of LCRA.

"Code" means the Internal Revenue Code of 1986, as amended.

"Contract Revenue Bonds" means certain bonds or other obligations issued pursuant to certain provisions of the Master Resolution.

"Contractual Commitment" means a written agreement between an Affiliate and LCRA pursuant to the Master Resolution and pursuant to which such Affiliate agrees:

- (1) to observe and perform the obligations that LCRA has covenanted to cause Affiliates to observe and perform under the Master Resolution and any Supplement;
- (2) to pay or otherwise transfer to LCRA such amounts as are required by the provisions of the Master Resolution and to grant to LCRA a first lien on, pledge of, and perfected security interest in the Transferred Assets and in all of the revenues of the Affiliate to secure the obligation to make such payments;
- (3) subject to any applicable legal restrictions relating to the disposition of assets by organizations described in Section 501(c)(3) of the Code, that upon liquidation or dissolution of such Affiliate all or a portion of the remaining assets of such Affiliate shall be transferred to LCRA in accordance with the organizational documents of such Affiliate;
- (4) to comply with covenants to be contained in the Contractual Commitment relating to its operations, assets, revenues, and obligations to LCRA which are substantially in the form of the covenants of LCRA contained in the Master Resolution; and
- (5) to prohibit the creation of any obligation payable from a lien on, pledge of, or security interest in the Transferred Assets or the revenues of the Affiliate on parity with or superior to the lien, pledge, and security interest created for the benefit of LCRA in the Contractual Commitment.

"Credit Agreement" means, collectively, a Parity Debt in the form of a loan agreement, revolving credit agreement, agreement establishing a line of credit, letter of credit, reimbursement agreement, insurance contract, commitments to purchase Parity Debt, purchase or sale agreement, interest rate swap, cap and floor agreement, or commitment or other contract or agreement authorized by LCRA as a Credit Agreement in connection with the authorization, issuance, sale, resale, security, exchange, payment, purchase, remarketing, or redemption of Parity Debt, interest on Parity Debt, or both.

"Credit Provider" means any bank, financial institution, insurance company, surety bond provider, or other entity which provides, executes, issues, or otherwise is a party to or provider of a Credit Agreement.

"Debt" means all indebtedness of LCRA payable from Pledged Revenues incurred or assumed by LCRA for borrowed money (including indebtedness arising under Credit Agreements) and all other financing obligations of LCRA that, in accordance with Accounting Principles, are included as a liability on a balance sheet, and including guarantees by LCRA of the obligations of Affiliates, but excluding noncash accounting adjustments. For the purpose of determining the "Debt" payable from the Pledged Revenues, there shall be excluded any Defeased Debt and any obligation of any entity whose financial statements are required by Accounting Principles to be consolidated with those of LCRA.

"Defeased Debt" means Defeased Debt as such term is defined under the heading "Defeasance of Parity Debt" below.

"Fiscal Year" means any consecutive twelve-month period designated by LCRA as its business year. At the time of the adoption of the Master Resolution, the Fiscal Year of LCRA ends on June 30 of each year.

"Funded Debt" of LCRA means all Parity Debt created, assumed, or guaranteed by LCRA that matures by its terms (in the absence of the exercise of any earlier right of demand), or is renewable at the option of LCRA, to a date more than one year after the original creation or assumption of such Parity Debt by LCRA.

"Government Obligations" means (a) direct noncallable obligations of the United States of America, including obligations which are unconditionally guaranteed by the United States of America (including interest strips of the Resolution Funding Corporation), which may be United States Treasury obligations such as its State and Local Government Series, and which may be in book-entry form and, to the extent allowed by law at the time of deposit, receipts, certificates or other similar documents evidencing direct ownership of future interest or principal payments due on direct obligations of the United States of America held in a custody or trust account by a commercial bank (having at least \$20,000,000 in capital stock, surplus and undivided profits) pursuant to a custody or trust agreement; (b) noncallable obligations of an agency or instrumentality of the United States, including obligations which are unconditionally guaranteed or insured by the agency or instrumentality and that, on the date of purchase, are rated as to investment quality by all nationally recognized credit rating agencies then rating such securities of not less than the highest rating category maintained by such rating agencies; and (c) noncallable obligations of a state or an agency or a county, municipality, or other political subdivision of a state that have been refunded and that, on the date of purchase, are rated as to investment quality by all nationally recognized credit rating agencies then rating such securities of not less than the highest rating category maintained by such rating agencies.

"Initial Contractual Commitment" means The Lower Colorado River Authority - LCRA Transmission Services Corporation Electric Transmission Facilities Contract, dated as of October 1, 2001, between LCRA and TSCorp, as amended, pursuant to which LCRA has conveyed, effective January 1, 2002, certain electric transmission and transformation assets to TSCorp.

"LCRA" and "Issuer" mean the Lower Colorado River Authority, or, when designated in connection with any covenant, action, or decision, the Board or any officer of LCRA acting in its behalf.

"LCRA Act" means Chapter 74, Acts of the 64th Legislature, Regular Session, 1975, together with all amendments thereto (now codified and amended in Chapter 8503, Texas Special District Local Laws Code).

"Master Resolution" means the "Master Resolution Establishing the Lower Colorado River Authority Revenue Financing Program," adopted by the Board on September 22, 1999, as may be amended or supplemented from time to time.

"Maturity" when used with respect to any Debt means the date on which the principal of such Debt or any installment thereof becomes due and payable as therein provided, whether at the Stated Maturity thereof, call for redemption, or otherwise.

"Obligated Affiliate" means an Affiliate that has entered into a Contractual Commitment with LCRA.

"Officer's Certificate" means a certificate signed by an Authorized Representative.

"Operating and Maintenance Expenses" means all reasonable and necessary costs and expenses incurred in the operation and maintenance of the properties and assets of LCRA according to Accounting Principles, but excluding (i) Separate System Projects, (ii) properties and assets financed with Contract Revenue Bonds, (iii) depreciation, (iv) amortization, (v) noncash accounting adjustments related to such Accounting Principles as GASB Statement No. 31 and FASB Statement No. 133, and (vi) costs and expenses of any entity whose financial statements are required by Accounting Principles to be consolidated with LCRA. The costs and expenses incurred by LCRA in connection with hedging contracts, take-or-pay contracts, and take-and-pay contracts for the purchase of power, water, or fuel shall constitute Operating and Maintenance Expenses.

"Opinion of Counsel" means a written opinion of counsel which shall be acceptable to LCRA.

"Outstanding" when used with respect to Parity Debt means, as of the date of determination, all Parity Debt theretofore delivered under the Master Resolution and any Supplement, except:

- (1) Parity Debt theretofore canceled and delivered to LCRA or delivered to the Paying Agent or the Registrar for cancellation;
- (2) Parity Debt deemed paid pursuant to the defeasance provisions of the Master Resolution or any comparable section of any Supplement;
- (3) Parity Debt upon transfer of or in exchange for and in lieu of which other Parity Debt has been authenticated and delivered pursuant to the Master Resolution and any Supplement; and
- (4) Parity Debt under which the obligations of LCRA have been released, discharged, or extinguished in accordance with the terms thereof;

provided, that, unless the same is acquired for purposes of cancellation, Parity Debt owned by LCRA shall be deemed to be Outstanding as though it was owned by any other Owner. In addition, Credit Agreements shall be deemed to be Outstanding until terminated in accordance with their terms.

"Outstanding Principal Amount" means as of any record date established by a Registrar in connection with a proposed amendment of the Master Resolution or any Supplement with respect to all Parity Debt that is in the form of bonds, notes, or other similar instruments that have a stated principal amount, the outstanding and unpaid principal amount of such Parity Debt on which interest is paid on a current basis and the outstanding and unpaid principal and compounded interest on such Parity Debt paying accrued, accreted, or compounded interest only at maturity and, with respect to Credit Agreements shall total the amount, if any, then due under such Credit Agreement if it was to be terminated as of the date of calculation of Outstanding Principal Amount.

"Owner" means the registered owner of any Parity Debt registered as to ownership, the holder of any Parity Debt payable to bearer, or the obligee of any Credit Agreement.

"Parity Debt" means all Debt of LCRA which may be issued, incurred, or assumed in accordance with the terms of the Master Resolution and a Supplement, having a lien on and pledge of the Pledged Revenues on parity with all other Parity Debt subject only to the lien and pledge securing Prior Encumbered Obligations, if any. Prior Encumbered Obligations, Subordinate Lien Obligations, Contract Revenue Bonds, and Debt issued or incurred with respect to Separate System Projects shall not constitute Parity Debt.

"Paying Agent" means the agent selected and appointed by LCRA for purposes of paying the principal of, premium, if any, and interest on the Bonds to the Owners thereof, and any successor to such agent.

"Paying Agent/Registrar" means collectively, the Paying Agent and the Registrar designated in each respective Supplement or any successor to such agent.

"Person" means any individual, corporation, partnership, firm, joint venture, association, joint-stock company, trust, unincorporated organization, or government or any agency or political subdivision thereof or any other entity.

"Pledged Revenues" means all amounts received pursuant to Contractual Commitments and all lawfully available funds of LCRA, including (i) all revenues, according to the Accounting Principles, received or derived by LCRA, and (ii) all fund balances attributable to such revenues. Pledged Revenues shall not include (i) customer's deposits while retained as such, (ii) contributions in aid of construction, (iii) earnings on proceeds (or amounts deemed to be proceeds pursuant to the Internal Revenue Code of 1986 (the "Code")), of Debt to the extent that LCRA is required to rebate such earnings to the United States of America pursuant to the Code, (iv) any investment earnings in any rebate fund established with respect to any Debt, (v) any moneys obtained pursuant to drawings on a letter of credit, line of credit, bond insurance policy or similar financial arrangement

securing the payment, and used to pay principal of, or premium and interest on, any Debt, (vi) any proceeds obtained pursuant to the remarketing of any Debt of LCRA, (vii) income derived from the operation or ownership of Separate System Projects or received pursuant to a contract entered into with respect to Contract Revenue Bonds, (viii) noncash accounting adjustments relating to an accounting rule such as GASB Statement No. 31 and FASB Statement No. 133, (ix) income and fund balances of any entity whose financial statements are required by Accounting Principles to be consolidated with those of LCRA and (x) and sales taxes collected on behalf of the State.

"Prior Encumbered Obligations" means obligations assumed by LCRA in connection with the acquisition of properties or assets which are secured by a lien on a portion of the Pledged Revenues which is superior to the lien established by the Master Resolution on behalf of Parity Debt.

"Registrar" means each entity designated in a Supplement as the registrar of a series or issue of Parity Debt.

"Resolution" means, with respect to each Series of bonds, the Master Resolution and the Supplement pertaining thereto.

"Revenue Financing Program" or "Financing Program" means the Lower Colorado River Authority Revenue Financing Program established by the Master Resolution.

"Securitized Costs" means LCRA's recoverable regulatory assets and stranded costs pursuant to the provisions of Chapter 40, Texas Utilities Code.

"Security Register" means the books and records kept and maintained by the Registrar relating to the registration, transfer, exchange, and payment of the Bonds and the interest thereon.

"Separate System Project" means any project or facilities acquired, constructed, owned, and/or operated, and any Securitized Costs financed or refinanced, where the revenues, records, and accounts attributable to such project, facilities, or Securitized Costs are kept and maintained separate and apart from LCRA's revenues, records, and accounts, and the revenues, receipts, proceeds, and other resources attributable to such Separate System Project are not pledged to the payment of Parity Debt and do not constitute Pledged Revenues.

"Series of Bonds" or "Series" mean any designated series of bonds issued pursuant to a Supplement.

"State" means the State of Texas.

"Stated Maturity" when used with respect to any Debt or any installment of interest thereon means any date specified in the instrument evidencing or authorizing such Debt or such installment of interest as a fixed date on which the principal of such Debt or any installment thereof or the fixed date on which such installment of interest is due and payable.

"Subordinate Lien Obligations" means the Debt LCRA reserves the right to issue under the Master Resolution, which obligation is payable from and secured by a lien on and pledge of the Pledged Revenues junior and subordinate to the lien and pledge securing the payment of Parity Debt.

"Supplement" means a resolution supplemental to, and authorized and executed pursuant to the terms of, the Master Resolution.

"Term of Issue" means with respect to any Balloon Debt a period of time equal to the greater of (i) the period of time commencing on the date of issuance of such Balloon Debt and ending on the final maturity date of such Balloon Debt or the maximum maturity date in the case of commercial paper or (ii) twenty-five years.

"Transferred Assets" means the respective properties and assets transferred to an Affiliate by LCRA pursuant to the provisions of the Master Resolution.

"Twenty-Eighth Supplement" means the Twenty-Eighth Supplemental Resolution, which was adopted pursuant to authority reserved by LCRA under the Master Resolution.

Security and Pledge

Parity Debt will be secured by and payable from a lien on and pledge of the Pledged Revenues, and the Board has assigned and pledged the Pledged Revenues to the payment of the Annual Debt Service Requirements of the Parity Debt, and the Pledged Revenues are further pledged to the establishment and maintenance of any funds which may be provided to secure the repayment of Parity Debt in accordance with the Master Resolution and any Supplement. Pledged Revenues will secure and pay Parity Debt, and such Parity Debt is not secured by or payable from a mortgage or deed of trust on any properties, of LCRA whether real, personal, or mixed, or any Affiliate other than the Pledged Revenues. Pursuant to State law, the pledge, security and lien on the Pledged Revenues for the benefit of the Parity Debt is established and perfected. The Owners of Parity Debt will never have the right to demand payment out of funds raised or to be raised by taxation, or from any source other than as specified in the Master Resolution or any Supplement. The lien on and pledge of Pledged Revenues for the benefit of the Parity Debt, with respect to the portion of Pledged Revenues representing revenues pledged to Prior Encumbered Obligations, is subject and subordinate to the lien and pledge established for the benefit of such Prior Encumbered Obligation, if any.

Rates and Fees

The Pledged Revenues are derived from the revenues of LCRA, including the rates and charges charged and collected by LCRA from those receiving services from LCRA and from amounts to be received from Contractual Commitments. LCRA will at all times maintain rates, fees, or charges for the sale or use of the output of, or goods or services provided by, the property of LCRA, sufficient, together with amounts received from other Pledged Revenues (excluding the proceeds from the sale of any properties or assets of LCRA used in carrying out its operations) and the anticipated receipt of proceeds of sale of any Debt of LCRA that will be used to pay the debt service of any Debt of LCRA issued in anticipation of such receipt, (i) to pay all Operating and Maintenance Expenses, (ii) to pay the Annual Debt Service Requirements and the debt service on all Subordinate Lien Obligations then Outstanding, all as the same respectively become due and payable, (iii) to maintain any reserve or reserves, or special fund or funds established by LCRA, and (iv) to pay any and every other indebtedness, liability, or obligation of LCRA reasonably expected to be payable from Pledged Revenues for the payment of money.

General Covenants

LCRA represents, covenants, and agrees that while Parity Debt or interest thereon is Outstanding:

(a) *Payment of Parity Debt.* LCRA will duly and punctually pay or cause to be paid, solely from the Pledged Revenues, the Annual Debt Service Requirements on, and other payments with respect to, each and every Parity Debt on the dates and at the places, as it accrues or matures, or becomes subject to mandatory redemption prior to maturity and such payments will be made in the manner provided in said Parity Debt and the Supplement governing its issuance.

(b) *Performance.* LCRA will perform at all times any and all covenants, undertakings, stipulations, and provisions contained in the Master Resolution and in each Supplement, and in each and every Parity Debt or evidence thereof.

(c) *Lawful Title.* LCRA lawfully owns, has title to, is lawfully possessed of, or lawfully has the right to use the lands, buildings, and facilities now constituting the property of LCRA, and it will defend said title and rights and the title and rights to any lands, buildings, and facilities which may hereafter become the property of LCRA.

(d) *Preservation of Lien; Maintenance of Properties and Assets.* Subject to the conditions set forth in the Master Resolution, LCRA will not do or suffer any act or thing whereby the pledge of the Pledged Revenues might or could be impaired and LCRA will (i) at all times maintain, preserve, and keep, or cause to be maintained, preserved, and kept, its properties and all additions and betterments thereto and extensions thereof and every part and parcel thereof in good repair, working order, and condition and (ii) from time to time make or cause to be made all necessary and proper repairs, renewals, capital additions, replacements, extensions, and betterments

thereto, so that at all times the business carried on in connection therewith may be properly and advantageously conducted. Provided, however, LCRA will not be obligated to maintain, preserve, and keep any of its properties and assets if, in the reasonable judgment of the Board, it would be uneconomical to do so.

LCRA agrees at all times to use its best efforts to (i) obtain or cause to be obtained and maintain or cause to be maintained in effect all permits and licenses for carrying out its operations, required by federal or state governmental agencies or bodies, (ii) comply with all federal or state laws or regulations applicable to the construction, operation, maintenance, and repair of the property of LCRA, or requiring a license for the maintenance or operation of any part thereof, and (iii) comply and assure compliance with the terms and conditions of any such permits and licenses.

(e) No Additional Encumbrance. LCRA will not incur additional Debt secured by the Pledged Revenues in any manner, except as permitted by the Master Resolution in connection with Parity Debt, unless said Debt is made junior and subordinate in all respects to the liens, pledges, covenants, and agreements of the Master Resolution and any Supplement and any Debt incurred by LCRA without satisfying the conditions for the issuance of Parity Debt is declared to be junior and subordinate in all respects to the liens, pledges, covenants, and agreements of the Master Resolution and any Supplement whether such status is noted or not.

(f) Investments and Security. LCRA will invest and secure money under its control in the manner prescribed by law for such funds and in accordance with the policies of the Board.

(g) Records; Annual Audit. LCRA will (and will cause each of its Affiliates to) at all times keep books of record and account, in accordance with Accounting Principles in accordance with the following provisions:

(i) As soon as practicable, but in no event more than one hundred and twenty (120) days after the last day of each Fiscal Year beginning with the Fiscal Year ended June 30, 2000, a financial report for LCRA for such Fiscal Year certified by the Certified Public Accountant approved by the Board prepared on a combined or consolidated basis to include the results of operations of LCRA and all Persons required to be consolidated or combined with LCRA in accordance with Accounting Principles and containing an audited combined balance sheet as of the end of such Fiscal Year, an audited combined statement of operations for such Fiscal Year, and an audited combined statement of cash flows of such Fiscal Year, showing in each case in comparative form the financial figures for the preceding Fiscal Year.

(ii) As soon as practicable, but in no event more than one hundred and twenty (120) days after the last day of each Fiscal Year beginning with the Fiscal Year ended June 30, 2000, a special-purpose combined financial statement reflecting only the operations of LCRA and all Obligated Affiliates for such Fiscal Year, certified by the Certified Public Accountant performing the audit required by subparagraph (i) of this subsection, and containing an audited combined balance sheet as of the end of such Fiscal Year, an audited combined statement of operations for such Fiscal Year, and an audited combined statement of cash flow for such Fiscal Year showing in each case in comparative form the financial figures for the preceding year (such balance sheet, statement of operations and statement of cash flow being referred to in the Master Resolution as the "LCRA Financing Program Special-Purpose Financial Statements").

Copies of each annual audit and the LCRA Financing Program Special-Purpose Financial Statements, described above in (i) and (ii), in either printed or electronic form, shall be furnished upon written request to any Owner of five percent (5%) of the Outstanding Parity Debt.

(h) No Other Liens on Pledged Revenues. Other than for the payment of the Parity Debt, the Pledged Revenues have not been pledged in any manner to the payment of any debt or obligation of LCRA.

(i) Taking Any Further Action Necessary. LCRA will pass, make, do, execute, acknowledge, and deliver each and every such further resolution, act, deed, conveyance, assignment, recording, filing, transfer, and assurance as may be necessary or desirable for the better assuring, conveying, granting, assigning, and confirming all and singular the rights to the Pledged Revenues pledged to the payment of Parity Debt, or intended so to be, or which LCRA may hereafter become bound to pledge.

(j) Insurance. To the extent that similar insurance is usually carried by public or governmental authorities operating like properties, LCRA will carry insurance on, or maintain a self-insurance program with respect to, its properties, at all times with responsible insurers, with policies payable to LCRA to the extent of its interest, against risks of direct physical loss, damage to, or destruction for such properties or any part thereof, and against accidents, casualties, or negligence, including liability insurance. LCRA agrees to furnish an instrument summarizing its insurance data to any Owner of 5% or more of Outstanding Parity Debt upon written request.

Issuance of Parity Debt

LCRA reserves and shall have the right and power to issue or incur Parity Debt for any purpose authorized by law pursuant to the provisions of the Master Resolution and a Supplement to be hereafter authorized. LCRA may incur, assume, guarantee, or otherwise become liable in respect of any Parity Debt if the Board finds that it will have sufficient funds to meet the financial obligations of LCRA, including the receipt of Pledged Revenues in amounts sufficient to satisfy the Annual Debt Service Requirements and to meet all other financial obligations of LCRA payable from Pledged Revenues. In addition, LCRA shall not issue or incur Parity Debt unless an Authorized Representative shall deliver to the Board an Officer's Certificate stating either (i) that, to the best of his or her knowledge, LCRA has not failed to comply with the covenants contained in the Master Resolution and each Supplement to any material extent, and LCRA is not in default in any material extent, in the performance and observance of any of the terms, provisions, and conditions hereof or thereof, or (ii) that, after the issuance of such Parity Debt to cure an existing default, LCRA will not be in default, to any material extent, with respect to the performance or observance of any of the terms, provisions, and conditions of the Master Resolution and each Supplement.

LCRA may establish a payment fund, a reserve fund, and/or any other fund or funds pursuant to the provisions of the applicable Supplement for the purpose of paying or securing a particular issue or series of Parity Debt or any specific group of issues or series of Parity Debt and the amounts once deposited in said funds shall no longer constitute Pledged Revenues but shall be held solely for the benefit of the Owners of the particular issue or series or group of issues or series of Parity Debt for which such fund was established. Each such fund shall be designated in such manner as is necessary to identify the Parity Debt it secures and to distinguish such fund from any other funds created for the benefit of any other Parity Debt. Prior to establishing any such fund an Authorized Officer shall deliver an Officer's Certificate to the Board to the effect that the establishment and operation of such fund will not have a material adverse effect on the ability of LCRA to comply with its covenants in the Master Resolution or in the Supplements authorizing the issuance of the Outstanding Parity Debt.

Subordinate Lien Obligations

Nothing contained in the Master Resolution shall prohibit or prevent, or be deemed or construed to prohibit or prevent, LCRA (i) from authorizing and issuing Subordinate Lien Obligations for any corporate use or purpose payable from the Pledged Revenues, or any identifiable portion of the Pledged Revenues, subject and subordinate to the payment of any Parity Debt and to the deposits and credit required to be made from the Pledged Revenues to any special fund or funds required pursuant to any Supplement established to secure the payment of Parity Debt, or (ii) from securing such Subordinate Lien Obligations and the payment thereof by a lien on and pledge of the Pledged Revenues, or any identifiable portion of the Pledged Revenues, junior and inferior to the lien on and pledge of the Pledged Revenues herein created for the payment and security of Parity Debt. The Board may establish a payment fund, a reserve fund, and/or any other fund or funds for the purpose of paying or securing a particular issue or series of Subordinate Lien Obligations or any specific group of issues or series of Subordinate Lien Obligations, and the amounts once deposited in said funds shall no longer constitute Pledged Revenues but shall be held solely for the benefit of the owners of the particular Subordinate Lien Obligations for which such fund was established.

Separate System Projects and Financings

Nothing in the Master Resolution will be construed to deny LCRA the right, and LCRA retains the right, to acquire, construct, own, and/or operate any project or facilities, and to finance or refinance the cost of any Separate System Project. LCRA further retains the right to issue or incur Debt obligations to finance the costs of such Separate System Projects and to secure such obligations in any manner permitted by law other than a pledge of Pledged Revenues. LCRA shall not designate as a Separate System Project all or any material portion of its electric generation or transmission, water, or wastewater properties or assets unless any Debt payable from

Pledged Revenues which is allocated to such properties or assets on the books and records of LCRA is retired or defeased in accordance with the defeasance provisions of the Master Resolution and such Debt.

Contract Revenue Bonds

LCRA hereby retains the right to issue or incur Debt obligations for the purpose of providing funds for the acquisition or construction of any facilities or for the right to use or benefit from any facilities which it may be empowered to acquire, construct, or finance for an Affiliate, another governmental agency, entity, or unrelated Person under proper statutory authority, with such obligations to be secured by and payable only from the proceeds of the lease, sale, or other contractual arrangements duly entered into with respect to such facilities or rights thereto. The proceeds received by LCRA under such leases, sales, or other contractual arrangements shall not constitute Pledged Revenues.

Dealings with Affiliates

Notwithstanding anything to the contrary contained in the Master Resolution, upon compliance with the Master Resolution, LCRA retains the right to transfer all or a substantial portion of its properties or assets to one or more Affiliates. Any contracts, agreements, or other obligations between LCRA and an Affiliate will comply with the respective provisions of the Master Resolution and each Supplement.

In addition, the Board shall exercise control over the operations of each Affiliate in accordance with law and the policies of the Board and shall cause each Affiliate to operate in a manner which, in the sole judgment of the Board, does not have a material adverse effect on the operations of LCRA or its ability to comply with its obligations under the Master Resolution and each Supplement. Specifically, the Board shall retain the right to approve any debt to be incurred by an Affiliate and will not approve the issuance or incurrence of the debt if, in the judgment of the Board, the satisfaction of the obligations relating to the debt will materially adversely affect the ability of the Affiliate to comply with the provisions of its Contractual Commitments to LCRA or its other legal obligations. Further, and to the extent permitted by law, the Board shall retain the right (i) to approve the budget of each Affiliate; (ii) to appoint and remove the members of the board of directors of each Affiliate; (iii) to approve the articles of incorporation and the by-laws, and any amendments thereto, of each Affiliate; (iv) to approve the disposition of all or substantially all of the assets of an Affiliate; and (v) to require that each Affiliate's fiscal year be the same as LCRA's Fiscal Year.

Nothing contained in the Master Resolution shall prevent LCRA from entering into or undertaking any activity with, for, or on behalf of an Affiliate, to the extent authorized by law, including, but not limited to, entering into all manner of contracts and agreements, such as interest rate, commodity, or other types of hedge or forward delivery agreements; providing, or entering into agreements or arrangements to provide, at such price or prices, if any, as LCRA shall determine, commodities, services, or personnel; guaranteeing obligations; loaning its credit; incurring liabilities; issuing Debt for any purpose authorized by law or the Master Resolution in such manner as LCRA shall determine; receiving payments or entering into Contractual Commitments or other contracts and agreements; or undertaking any other lawful act or activity with respect to an Affiliate. In addition, prior to LCRA issuing any Debt payable from Pledged Revenues on behalf of an Affiliate or guaranteeing the obligations of an Affiliate, (i) the Board and such Affiliate shall enter into a Contractual Commitment obligating the Affiliate to make payments to LCRA in amounts and at the times necessary to allow LCRA to pay the Annual Debt Service Requirements, if any, relating to such Debt or to pay amounts, including interest thereon, advanced by LCRA pursuant to the guarantee and to pay all expenses and costs of LCRA, including overhead, related to the activities of LCRA under the Contractual Commitment, and (ii) the Board shall find that the financial projections of the Affiliate provide a reasonable basis for determining that the Affiliate will have the financial ability to meet its obligations with respect to the Contractual Commitment.

Disposition of Assets

To the extent provided by law, LCRA may convey, sell, or otherwise dispose of any of its properties or other assets provided that prior to such disposition (i) the Board shall find that, after the conveyance, sale, or other disposition of such properties or assets, it anticipates that Pledged Revenues to be received in each Fiscal Year that Parity Debt is scheduled to be outstanding will be sufficient to satisfy the Annual Debt Service Requirements and to meet all other financial obligations of LCRA that are payable from Pledged Revenues and (ii) if the transfer is of all or a material portion of its electric generation or transmission, water, or wastewater properties or assets and is to any person other than to an Affiliate, LCRA receives confirmation from each nationally recognized credit

rating agency then maintaining a rating with respect to the Outstanding Parity Debt that such transfer, in and of itself, will not cause the then current rating to be lowered or withdrawn. LCRA need not comply with the requirement of clause (ii) above, in the event that a majority of the Outstanding Principal Amount of the Parity Debt is insured by one or more municipal bond insurance policies and each respective bond insurer consents to the transfer.

In addition, prior to the transfer by LCRA of all or a material portion of its electric generation or transmission, water, or wastewater properties or assets to an Affiliate (respectively, the "Transferred Assets"), (i) the Board and such Affiliate shall enter into a Contractual Commitment obligating the Affiliate to make payments to LCRA in amounts and at the times necessary to allow LCRA to pay the Annual Debt Service Requirements allocated to the respective Transferred Assets as reflected on the books and records of LCRA and to pay all expenses and costs of LCRA, including overhead, related to the activities of LCRA under the Contractual Commitment, (ii) the Board shall find that the financial projections of the Affiliate provide a reasonable basis for determining that the Affiliate will have the financial ability to meet its obligations with respect to the Contractual Commitment, and (iii) the Board shall have received an opinion of Bond Counsel, subject to customary limitations, to the effect that the Contractual Commitment constitutes the legal, valid, and enforceable obligation of the Affiliate. LCRA further covenants that it will not grant a security interest in the Contractual Commitment for the benefit of any other person.

Remedies

Any Owner of Parity Debt, including the Bonds, in the event of default in connection with any covenant contained the Master Resolution or in any Supplement, or default in the payment of said obligations, or of any interest due thereon, or other costs and expenses related thereto, may require the Board, LCRA, its officials and employees, and any appropriate official of the State, to carry out, respect, or enforce the covenants and obligations of the Master Resolution and any Supplement, by all legal and equitable means, including specifically, but without limitation, the use and filing of mandamus proceedings in any court of competent jurisdiction against the Board, LCRA, its officials and employees, or any appropriate official of the State. The Resolution does not establish other remedies or specifically enumerate the events of default with respect to the Bonds. The Resolution does not provide for a trustee to enforce the covenants and obligations of LCRA.

LCRA has not waived its sovereign immunity from suit or liability with respect to the Bonds, and the owners thereof are prevented by operation of LCRA's sovereign immunity from bringing a suit against LCRA in a court of law to adjudicate a claim to enforce the Bonds or for damages for breach of the Bonds.

However, State courts have held that sovereign immunity does not apply to mandamus actions. Accordingly, if LCRA defaults in the payment of principal or interest on the Bonds or in the observation or performance of any other covenants set forth in the Resolution, any Owner of Parity Debt may seek a writ of mandamus to compel LCRA or its officials to carry out the legally imposed duties with respect to the Resolution if LCRA's obligations thereunder are not uncertain or disputed. The issuance of a writ of mandamus is controlled by equitable principles, so it rests with the discretion of the court, but it may not be arbitrarily refused. The Owners have no remedy of acceleration of maturity of the Bonds in the event of default and, consequently, the remedy of mandamus may have to be relied upon from year to year. Accordingly, the enforcement of the remedy of mandamus may be difficult and time consuming. All legal actions to enforce the remedy of mandamus would have to be undertaken at the initiative of, and be financed by, such Owners of Parity Debt. No assurance can be given that a mandamus or other legal action to enforce a default under the Resolution would be successful.

Defeasance of Parity Debt

(a) *Deemed Paid.* The principal of and/or the interest and redemption premium, if any, on any Parity Debt (other than Credit Agreements) will be deemed to be paid, retired, and no longer Outstanding (a "Defeased Debt") within the meaning of the Master Resolution, except to the extent provided in subsection (d) immediately below, when all payments due on such Defeased Debt, to the due date or dates thereof (whether such due date or dates be by reason of maturity, upon redemption, optional or mandatory tender, or otherwise) either (i) will have been made or caused to be made in accordance with the terms thereof or (ii) will have been provided for on or before such due date by irrevocably depositing with, in trust and irrevocably set aside exclusively for such purpose, or making available to the Paying Agent for such Parity Debt for such payment (1) lawful money of the United States of America sufficient to make such payment, (2) Government Obligations which mature as to principal and interest in such amounts and at such times as will insure the availability, without reinvestment, of sufficient money

to provide for such payment, certified by an independent public accounting firm of national reputation, or (3) any combination of (1) and (2) above, and when (x) any required notice of redemption or tender has been given or irrevocable provisions for the giving of such notices will have been made and (y) proper arrangements have been made by the Board with each such Paying Agent for the payment of its services until after all Defeased Debt will have become due and payable. At such time as the principal of and/or the interest and redemption premium, if any, on Parity Debt will be deemed to be Defeased Debt hereunder, as aforesaid, such Defeased Debt will no longer be secured by, payable from, or entitled to the benefits of, the Pledged Revenues, and such principal, redemption premium, if any, and/or interest will be payable solely from such money and/or Government Obligations, and will not be regarded as Outstanding for any purposes other than payment, transfer, and exchange.

(b) Retention of Rights. Notwithstanding the provisions of subsection (a) immediately above, LCRA may retain the right in each Supplement to be exercised upon the defeasance of any Defeased Debt authorized by such Supplement which is to be paid at its maturity, to later call that Defeased Debt for redemption in accordance with the provisions of such Supplement provided that, LCRA: (1) in the proceedings providing for such defeasance, expressly reserves the right to call the Defeased Debt for redemption; (2) gives notice of the reservation of that right to the owners of the Defeased Debt immediately following the defeasance; (3) directs that notice of the reservation be included in any redemption notices that it authorizes; and (4) at the time of the redemption, satisfies the conditions of subsection (a) with respect to such Defeased Debt as though it was being defeased at the time of the exercise of the option to redeem the Defeased Debt, after taking the redemption into account in determining the sufficiency of the provisions made for the payment of the Defeased Debt.

(c) Investments. Any escrow agreement or other instrument entered into between LCRA and the Paying Agent pursuant to which the money and/or Government Obligations are held by the Paying Agent for the payment of Defeased Debt may contain provisions permitting the investment or reinvestment of such moneys in Government Obligations or the substitution of other Government Obligations upon the satisfaction of the requirements specified in subsection (a)(i) or (ii). All income from such Government Obligations received by the Paying Agent which is not required for the payment of Parity Debt and interest thereon, with respect to which such money has been so deposited, will be remitted to LCRA, or deposited as directed in writing by LCRA.

(d) Credit Agreements. Each Credit Agreement shall contain provisions governing the termination and discharge of the obligations thereunder.

Amendment and Waiver of Provisions of the Master Resolution

(a) Amendment of Master Resolution Without Consent. The Master Resolution and the rights and obligations of LCRA and of the Owners of Outstanding Parity Debt may be modified or amended at any time without notice to or the consent of any Owner of Outstanding Parity Debt, solely for any one or more of the following purposes:

(i) To add to the covenants and agreements of LCRA contained in the Master Resolution, other covenants and agreements thereafter to be observed, or to surrender any right or power reserved to or conferred upon LCRA in the Master Resolution; or

(ii) To cure any ambiguity or inconsistency, or to cure or correct any defective provisions contained in the Master Resolution; or

(iii) To make such other changes in the Master Resolution as LCRA may deem necessary or desirable and which will not, in the judgment of the Board, materially adversely affect the interests of the Owners of Outstanding Parity Debt.

(b) Amendment of Master Resolution With Consent. Subject to the other provisions of the Master Resolution, the Owners of Outstanding Parity Debt aggregating a majority in Outstanding Principal Amount will have the right from time to time to approve any amendment, other than amendments described in (a) immediately above, to the Master Resolution which may be deemed necessary or desirable by LCRA, provided, however, that nothing contained in the Master Resolution will permit or be construed to permit, without the approval of all Owners of Outstanding Parity Debt (unless such amendment will be determined by the Board to affect only the Owners of certain Parity Debt, in which case such amendment will not be made without the approval of the Owners so affected), the amendment of the terms and conditions in the Master Resolution so as to:

(i) Grant to the Owners of any Outstanding Parity Debt a priority over the Owners of any other Outstanding Parity Debt; or

(ii) Materially adversely affect the rights of the Owners of less than all Parity Debt then Outstanding;
or

(iii) Change the minimum percentage of the Outstanding Principal Amount necessary for consent to such amendment; or

(iv) Reduce the rate of interest borne by any Outstanding Parity Debt; or

(v) Reduce the amount of the principal payable on any Outstanding Parity Debt; or

(vi) Modify the terms of payment of principal or interest on any Outstanding Parity Debt, or impose any conditions with respect to such; or

(vii) Amend this subsection (b).

(c) Receipt of Consents. With respect to any amendment undertaken pursuant to paragraph (b) immediately above, whenever at any time LCRA shall first receive an instrument or instruments executed by all of the Owners or the Owners of a majority in Outstanding Principal Amount, as appropriate, which instrument or instruments shall refer to the proposed amendment described in said notice and which specifically consent to and approve such amendment in substantially the form of the copy thereof on file as aforesaid, the Board may adopt the amendatory resolution in substantially the same form.

(d) Effect of Amendments. Upon the adoption by the Board of any resolution to amend the Master Resolution, the Master Resolution will be deemed to be amended in accordance with the amendatory resolution, and the respective rights, duties, and obligations of LCRA and all Owners of then Outstanding Parity Debt and all future Parity Debt will thereafter be determined, exercised, and enforced under the Master Resolution, as amended.

(e) Consent Irrevocable. Any consent given by any Owner of Parity Debt pursuant to the provisions of this Section will be irrevocable for a period of six months from the date of the first publication or other service of the notice or the date of such consent, whichever is later, and will be conclusive and binding upon all future Owners of the same Parity Debt during such period. Such consent may be revoked at any time after the applicable period of time that a consent is irrevocable by the Owner who gave such consent, or by a successor in title, by filing notice with the Registrar for such Parity Debt and LCRA, but such revocation will not be effective if the Owners of the requisite amount of the Outstanding Principal Amount, prior to the attempted revocation, consented to and approved the amendment. Notwithstanding the foregoing, any consent given by an Owner at the time of and in connection with the initial sale or incurrence of an issue or series Parity Debt by LCRA will be irrevocable.

(f) Certain Parity Debt Not Considered Outstanding. For amendment purposes, Parity Debt owned by or held for the account of LCRA will not be considered as Outstanding.

(g) Waiver of Certain Covenants. LCRA may omit in any particular instance to comply with any covenant or condition set forth in certain provisions of the Master Resolution if before or after the time for such compliance the Owners of the same percentage in principal amount of all Parity Debt then Outstanding, the consent of which would be required for the amendment of the provisions hereof to permit such noncompliance, shall either waive such compliance in such instance or generally waive compliance with such covenant or condition, but no such waiver shall extend to or affect such covenant or condition except to the extent so expressly waived and, until such waiver shall become effective, the obligations of LCRA and the duties of LCRA in respect of any such covenant or condition shall remain in full force and effect.

Amendment of the Twenty-Eighth Supplement

(a) *Amendment of the Twenty-Eighth Supplement Without Consent.* Subject to the provisions of the Master Resolution, the Twenty-Eighth Supplement and the rights and obligations of LCRA and of the Owners of the Outstanding Bonds may be modified or amended at any time without notice to or the consent of any Owner of the Bonds or any other Parity Debt, solely for any one or more of the following purposes:

(i) To add to the covenants and agreements of LCRA contained in the Twenty-Eighth Supplement, other covenants and agreements thereafter to be observed, or to surrender any right or power reserved to or conferred upon LCRA in the Twenty-Eighth Supplement; or

(ii) To cure any ambiguity or inconsistency, or to cure or correct any defective provisions contained in the Twenty-Eighth Supplement, upon receipt by LCRA of an opinion of Bond Counsel, that the same is needed for such purpose, and will more clearly express the intent of the Twenty-Eighth Supplement; or

(iii) To supplement the security for the Bonds, replace or provide additional credit facilities, or change the form of the Bonds or make such other changes in the provisions of the Twenty-Eighth Supplement, as LCRA may deem necessary or desirable and that shall not, in the judgment of LCRA, materially adversely affect the interests of the Owners of the Outstanding Bonds; or

(iv) To make any changes or amendments requested by any bond rating agency then rating or requested to rate the Bonds, as a condition to the issuance or maintenance of a rating or as required by the office of the Texas Attorney General as a condition to the approval of the Bonds, which changes or amendments do not, in the judgment of LCRA, materially adversely affect the interests of the Owners of the Outstanding Bonds.

(b) *Amendment of the Twenty-Eighth Supplement With Consent.* Subject to the other provisions of the Twenty-Eighth Supplement and the Master Resolution, the Owners of Outstanding Bonds aggregating a majority in Outstanding Principal Amount will have the right from time to time to approve any amendment, other than amendments described in (a) immediately above, to the Twenty-Eighth Supplement which may be deemed necessary or desirable by LCRA, provided, however, that nothing contained in the Twenty-Eighth Supplement permits, without the approval of the Owners of all Outstanding Bonds, the amendment of the terms and conditions in the Twenty-Eighth Supplement or in the Bonds so as to:

(i) Make any change in the maturity of the Outstanding Bonds;

(ii) Reduce the rate of interest borne by Outstanding Bonds;

(iii) Reduce the amount of the principal payable on Outstanding Bonds;

(iv) Modify the terms of payment of principal of or interest on the Outstanding Bonds, or impose any conditions with respect to such payment;

(v) Affect the rights of the Owners of less than all Bonds then Outstanding; or

(vi) Change the minimum percentage of the Outstanding Principal Amount of Bonds necessary for consent to such amendment.

Retention of Redemption Rights of Defeased Bonds

Pursuant to the defeasance provisions of the Master Resolution, LCRA reserves the right to exercise its redemption rights with respect to any of the Bonds defeased pursuant to the Master Resolution.

APPENDIX B

**LOWER COLORADO RIVER AUTHORITY
MANAGEMENT'S DISCUSSION AND ANALYSIS**

AND

**AUDITED FINANCIAL STATEMENTS FOR THE FISCAL YEARS ENDED
JUNE 30, 2008 AND 2007**

AND

**UNAUDITED SUPPLEMENTAL CONSOLIDATING SCHEDULES FOR THE
FISCAL YEARS
ENDED JUNE 30, 2008 AND 2007**

**Lower Colorado River Authority
Management's Discussion and Analysis
Year Ended June 30, 2008**

Overview of the Financial Statements

In accordance with Governmental Accounting Standards Board Statement No. 34, "Basic Financial Statements – Management's Discussion and Analysis – for State and Local Governments," LCRA is considered a special-purpose government engaged only in business-type activities. Statement No. 34 requires the following components in a governmental entity's annual report:

Management's Discussion and Analysis

The purpose is to provide an objective and easily readable analysis of the government's financial activities based on currently known facts, decisions or conditions.

Balance Sheets

Assets and liabilities of proprietary funds should be presented to distinguish between current and long-term assets and liabilities.

Statements of Revenues, Expenses and Changes in Equity

This statement provides the operating results broken into the categories of operating revenues and expenses, nonoperating revenues and expenses, prior costs recovered for revenue, capital contributions and special items.

Statements of Cash Flows

Sources and uses of cash are classified using the direct method as resulting from operating, non-capital financing, capital and related financing or investing activities.

Financial Highlights

Condensed Balance Sheets

	June 30, 2008	June 30, 2007	June 30, 2006	2008 vs 2007	2007 vs 2006
<i>(Dollars in Thousands)</i>					
Current assets	\$ 473,586	\$ 397,068	\$ 389,440	19%	2%
Capital assets, net	2,827,370	2,585,662	2,464,871	9%	5%
Other long-term assets	578,361	562,092	511,225	3%	10%
Total Assets	<u>\$ 3,879,317</u>	<u>\$ 3,544,822</u>	<u>\$ 3,365,536</u>	9%	5%
Current liabilities	\$ 482,436	\$ 488,797	\$ 335,856	(1%)	46%
Long-term liabilities	2,578,114	2,288,133	2,305,351	13%	(1%)
Total Liabilities	<u>3,060,550</u>	<u>2,776,930</u>	<u>2,641,207</u>	10%	5%
Equity - Invested in capital assets, net of related debt	636,236	584,942	568,927	9%	3%
Equity - Restricted other	31,873	24,622	29,551	29%	(17%)
Equity - Unrestricted	150,658	158,328	125,851	(5%)	26%
Total Equity	<u>818,767</u>	<u>767,892</u>	<u>724,329</u>	7%	6%
Total Liabilities and Equity	<u>\$ 3,879,317</u>	<u>\$ 3,544,822</u>	<u>\$ 3,365,536</u>	9%	5%

2008 Compared to 2007

In FY 2008, current assets increased \$76.5 million or 19 percent. This increase was due to a \$45.4 million increase in net receivables primarily due to higher electric billing as a result of hotter temperatures compared to June 2007. The variance is also due to a \$30.7 million increase in gas and coal inventory balances compared to prior year.

Other long-term assets increased \$16.3 million or 3 percent compared to June 2007. This variance was caused by a decrease of \$33.1 million in unrestricted investments offset by an increase of \$43.5 million in deferred charges. The decrease in unrestricted investments results from investment purchases of \$268.2 million less investment maturities of \$306 million. The increase in deferred charges is primarily due to a \$34.9 million increase in costs to be recovered as a result of more costs deferred to future period rate recoveries.

2007 Compared to 2006

In FY 2007, other long-term assets increased \$50.9 million or 10 percent. This increase was due primarily to the LCRA revenue fund purchasing investment securities with maturities over one year, as well as increases in the construction fund related to issuances of tax exempt commercial paper.

Current liabilities increased \$152.9 million or 46 percent in FY 2007 due primarily to the issuance of tax-exempt commercial paper to fund construction costs.

Long-term liabilities decreased \$17.2 million or 1 percent in FY 2007 as a result of a decrease in accounts payable primarily related to construction for LCRA Transmission Services Corporation, a component unit of LCRA (see Note 1).

Condensed Statements of Revenues, Expenses and Changes in Equity

	Year Ended June 30,			2008 vs 2007	2007 vs 2006
	2008	2007	2006	Favorable/ (Unfavorable)	Favorable/ (Unfavorable)
	<i>(Dollars in Thousands)</i>				
Operating revenues	\$ 1,187,825	\$ 1,091,886	\$ 1,045,407	9%	4%
Operating expenses	(1,036,087)	(943,032)	(909,262)	(10%)	(4%)
Operating income	151,738	148,854	136,145	2%	9%
Interest and other income	24,072	32,509	14,878	(26%)	119%
Interest and other expenses	(158,313)	(142,750)	(120,917)	(11%)	(18%)
(Prior) Costs to be recovered from revenues	27,761	(5,134)	(13,715)	641%	63%
Income before capital contributions and special item	45,258	33,479	16,391	35%	104%
Capital contributions	5,617	11,477	11,304	(51%)	2%
Special Item - Loss on early defeasance of debt	-	(1,393)	(1,450)	100%	4%
Change in equity	50,875	43,563	26,245	17%	66%
Equity, Beginning of Year	767,892	724,329	698,084	6%	4%
Equity, End of Year	\$ 818,767	\$ 767,892	\$ 724,329	7%	6%

2008 Compared to 2007

Operating income remained stable from FY 2007 to FY 2008 due to an increase in rates offset by an increase in fuel expense. Interest and other income decreased \$8.4 million or 26 percent due to the cancellation of the securities lending program in May 2007. In FY 2008 there was an increase in interest and other expenses of \$15.6 million or 11 percent primarily due to \$10.6 million less interest capitalized to projects in FY 2008 compared to FY 2007. Most of the decrease in capitalized interest is a result of Transmission Services Corporation paying for debt service in current rates as a result of an early settlement of the rate case. The increase is also due to \$9.2 million of amortization of a loss on refunding recognized in April 2008 related to the refunding of LCRA Transmission Services

Corporation Series 2003A Bonds offset by a decrease of \$8 million due to the cancellation of the securities lending program.

Costs to be recovered from revenues increased \$32.9 million due to more costs deferred to future period rate recoveries.

Capital contributions decreased \$5.9 million or 51 percent from prior year primarily resulting from less construction related contributions for water utilities in FY 2008 compared to FY 2007.

2007 Compared to 2006

Operating income remained stable from FY 2006 to FY 2007 due to a slight decrease in rates offset by higher demand. Interest and other income increased \$17.6 million or 119 percent from FY 2006. This increase was primarily due to additional interest income recorded for the securities lending program begun in July 2006. Also in FY 2007, interest and other expenses increased \$21.8 million or 18 percent compared to FY 2006. This increase was primarily due to interest expense recorded related to the securities lending program in FY 2007. This program was cancelled in May 2007.

Costs to be recovered from revenues decreased \$8.6 million or 63 percent in FY 2007 as more cost were recovered through rates this fiscal year compared to FY 2006.

Capital Expansion and Improvement Program

LCRA's capital improvement program for FY 2009 through FY 2013 is \$2.7 billion, with \$2.2 billion or 81 percent to be debt funded. The forecasted capital expenses are for the expansion of generation facilities, transmission services and water and wastewater services, as well as additional corporate infrastructure and facilities. LCRA continues to expand its portfolio of generation resources to provide long-term stability and competitiveness in energy prices and will continue its water and wastewater services expansion due to the region's growing population. LCRA TSC continues to maintain and expand the electric transmission system to ensure reliable service.

The capital budget is expected to be applied as follows:

- (1) \$1.4 billion for generation and system improvements.
- (2) \$928 million for transmission projects.
- (3) \$260 million for dam improvements and modernization, and acquisition and construction of water and wastewater utilities and facilities.
- (4) \$144 million for parks and corporate facilities.

LCRA's forecasted capital program includes funds for the implementation of self-build peaking technology for 2010 and the installation of SO₂ scrubbers for two coal-fired generating units jointly owned by LCRA and the City of Austin.

The capital program will be funded by cash provided by operating activities and proceeds from long-term bond (including LCRA bonds and LCRA bonds issued on behalf of LCRA TSC) and commercial paper issuances.

The forecasted capital program is subject to periodic review and revision and may change significantly because of a number of factors including economic conditions and regulatory constraints.

Capital Asset Activity

- \$373.7 million was expended for construction activities in FY 2008. The majority of these costs were for purchase and construction of additional generation and transmission facilities and improvements to existing generation facilities.
- \$132 million of depreciation expense and asset retirements were recorded in FY 2008 on plant in service.
- For additional detail, see Capital Asset Activity table in Note 7 of the Notes to the Financial Statements.

Debt Activity

- During FY 2008, LCRA issued \$207.8 million of tax-exempt commercial paper, of which \$110.1 million was on behalf of LCRA TSC. In addition, LCRA issued \$1.6 million of taxable commercial paper. The proceeds were used to fund various capital projects and refund debt.
- In FY 2008, LCRA made \$81.3 million of scheduled payments and \$133.4 million of interest payments.
- In FY 2008, LCRA repaid \$5.1 million of tax-exempt commercial paper.
- On January 3, 2008, LCRA defeased approximately \$2.5 million from the LCRA Series 1999A, 1999B, 1999E, 1999F, 2001, 2002, 2003, and 2004D.
- On February 5, 2008, LCRA on behalf of LCRA TSC refunded \$6.4 million of LCRA TSC tax-exempt commercial paper.
- On April 22, 2008, LCRA on behalf of LCRA TSC used \$50 million of tax-exempt commercial paper proceeds to refund \$50 million of LCRA TSC Series 2003A Auction Rate bonds.
- On June 11, 2008, LCRA on behalf of LCRA TSC issued approximately \$165.2 million of Transmission Contract Refunding Revenue Bonds, Series 2008. The proceeds from the issue were used to refund \$158.6 million of tax-exempt commercial paper. LCRA also issued \$196 million of LCRA Series 2008 Refunding Revenue Bonds. The proceeds from this issue were used to refund \$204.4 million of tax-exempt commercial paper.
- For additional detail, see Note 3 of the Notes to the Financial Statements.

INDEPENDENT AUDITORS' REPORT

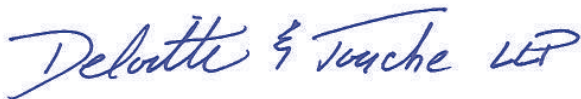
To the Board of Directors
Lower Colorado River Authority
Austin, Texas

We have audited the accompanying balance sheets of the Lower Colorado River Authority ("LCRA") as of June 30, 2008 and 2007, and the related statements of revenues, expenses and changes in equity, and cash flows for the years then ended. These financial statements are the responsibility of LCRA's management. 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 of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of LCRA's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such financial statements present fairly, in all material respects, the financial position of LCRA as of June 30, 2008 and 2007, and the results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

Management's Discussion and Analysis is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.



October 6, 2008

LOWER COLORADO RIVER AUTHORITY
BALANCE SHEETS

(Dollars in Thousands)

	June 30, 2008	June 30, 2007
<i>Assets</i>		
Current Assets:		
Cash and cash equivalents	\$ 113,209	\$ 116,852
Investments	39,703	48,069
Receivables, net	173,482	128,039
Accrued interest receivable	477	690
Inventories	132,048	101,374
Other	14,667	2,044
Total current assets	<u>473,586</u>	<u>397,068</u>
Long-term Assets:		
Restricted cash and cash equivalents	<u>23,135</u>	<u>24,866</u>
Restricted investments	<u>66,325</u>	<u>58,499</u>
Unrestricted investments	<u>53,947</u>	<u>87,058</u>
Capital assets:		
Utility plant in service	3,775,800	3,538,063
Construction work in progress	308,223	200,272
Oil and gas property	28,158	28,158
Other physical property	53,591	51,995
Less accumulated depreciation	<u>(1,338,402)</u>	<u>(1,232,826)</u>
Capital assets, net	<u>2,827,370</u>	<u>2,585,662</u>
Water rights, net	<u>87,397</u>	<u>87,397</u>
Other	<u>11,107</u>	<u>11,348</u>
Deferred charges:		
Costs to be recovered from future revenues	251,586	216,695
Unamortized debt expense	35,475	31,251
Contract extension settlement with major customers	6,583	7,358
Other	42,806	37,620
Deferred charges, net	<u>336,450</u>	<u>292,924</u>
Total long-term assets	<u>3,405,731</u>	<u>3,147,754</u>
Total Assets	<u>\$ 3,879,317</u>	<u>\$ 3,544,822</u>

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

LOWER COLORADO RIVER AUTHORITY
BALANCE SHEETS

(Dollars in Thousands)

	June 30, 2008	June 30, 2007
<i>Liabilities</i>		
Current Liabilities:		
Accounts payable	\$ 212,458	\$ 192,463
Compensated absences	11,030	9,872
Bonds, notes, and loans payable	258,948	286,462
Total current liabilities	<u>482,436</u>	<u>488,797</u>
Long-term Liabilities:		
Accounts payable from restricted assets	43,033	17,592
Bonds, notes, and loans payable	2,358,284	2,123,227
Deferred credits and other	176,797	147,314
Total long-term liabilities	<u>2,578,114</u>	<u>2,288,133</u>
Total liabilities	<u>3,060,550</u>	<u>2,776,930</u>
<i>Equity</i>		
Invested in capital assets, net of related debt	636,236	584,942
Restricted other	31,873	24,622
Unrestricted	150,658	158,328
Total equity	<u>818,767</u>	<u>767,892</u>
Total Liabilities and Equity	<u>\$ 3,879,317</u>	<u>\$ 3,544,822</u>

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

LOWER COLORADO RIVER AUTHORITY
STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN EQUITY

(Dollars in Thousands)

	Year Ended June 30,	
	2008	2007
Operating Revenues		
Electric	\$ 1,064,075	\$ 991,333
Water, wastewater and irrigation	62,488	55,863
Other	61,262	44,690
Total operating revenues	<u>1,187,825</u>	<u>1,091,886</u>
Operating Expenses		
Fuel	470,184	399,790
Purchased power	178,073	177,381
Operations	221,477	208,844
Maintenance	44,125	44,462
Depreciation, depletion and amortization	122,228	112,555
Total operating expenses	<u>1,036,087</u>	<u>943,032</u>
Operating income	151,738	148,854
Nonoperating Revenues (Expenses)		
Interest and other income	24,072	32,509
Interest and other expenses	(158,313)	(142,750)
Total nonoperating revenues (expenses)	<u>(134,241)</u>	<u>(110,241)</u>
Income before (prior) costs to be recovered from revenues, capital contributions and special item	17,497	38,613
(Prior) Costs to be Recovered from Revenues	<u>27,761</u>	<u>(5,134)</u>
Income before capital contributions and special item	45,258	33,479
Capital Contributions	5,617	11,477
Special Item - Loss on Early Defeasance of Debt	<u>-</u>	<u>(1,393)</u>
Change in Equity	50,875	43,563
Total Equity, Beginning of Year	<u>767,892</u>	<u>724,329</u>
Total Equity, End of Year	<u>\$ 818,767</u>	<u>\$ 767,892</u>

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

LOWER COLORADO RIVER AUTHORITY
STATEMENTS OF CASH FLOWS

(Dollars in Thousands)

	Year Ended June 30,	
	2008	2007
Cash Flows From Operating Activities		
Received from customers	\$ 1,162,806	\$ 1,077,517
Payments for goods and services	(775,365)	(649,331)
Payments to employees	(162,805)	(160,194)
Other expenses	(5,650)	(2,583)
Net cash provided by operating activities	<u>218,986</u>	<u>265,409</u>
Cash Flows From Noncapital Financing Activities		
Grant proceeds received	8,210	9,605
Other expenses	(1,613)	(8,076)
Net cash provided by noncapital financing activities	<u>6,597</u>	<u>1,529</u>
Cash Flows From Capital and Related Financing Activities		
Purchase of property, plant and equipment	(353,043)	(285,641)
Proceeds from sale of capital assets	6,696	241
Debt issue costs	(7,019)	(1,893)
Contributed capital received for capital expenses	5,937	10,379
Proceeds from bond issues and commercial paper	699,162	405,358
Debt principal payments and commercial paper redemptions	(86,421)	(89,345)
Interest paid	(125,731)	(112,203)
Payments to refund and defease debt	(421,990)	(154,381)
Net cash used in capital and related financing activities	<u>(282,409)</u>	<u>(227,485)</u>
Cash Flows From Investing Activities		
Sale and maturity of investment securities	306,003	276,649
Purchase of investment securities	(268,212)	(296,546)
Interest received	13,519	23,858
Infrastructure financial assistance activity	142	485
Net cash provided by investing activities	<u>51,452</u>	<u>4,446</u>
Net Increase (Decrease) in Cash and Cash Equivalents	(5,374)	43,899
Cash and Cash Equivalents, Beginning of Year	141,718	97,819
Cash and Cash Equivalents, End of Year	<u>\$ 136,344</u>	<u>\$ 141,718</u>

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

LOWER COLORADO RIVER AUTHORITY
STATEMENTS OF CASH FLOWS

(Dollars in Thousands)

	Year Ended June 30,	
	2008	2007
Reconciliation of Operating Income to Net Cash Provided by Operating Activities		
Operating income	\$ 151,738	\$ 148,854
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation, depletion and amortization	122,228	112,555
Changes in assets and liabilities:		
Accounts receivable	(45,360)	12,033
Inventories	(30,674)	(3,748)
Other current assets	(12,623)	(1,186)
Current liabilities	22,467	20,604
Other deferred charges and long-term assets	(6,359)	(7,983)
Deferred credits and other long-term liabilities	17,569	(15,720)
Net cash provided by operating activities	<u>\$ 218,986</u>	<u>\$ 265,409</u>
Noncash Investing Activities		
Investment market adjustments	<u>\$ 4,140</u>	<u>\$ 4,910</u>
Noncash Financing for Property, Plant and Equipment Expenditures		
Purchase of equipment through short-term trade payables	<u>\$ 24,410</u>	<u>\$ -</u>
Asset retirement obligation	<u>\$ -</u>	<u>\$ (9,270)</u>
Acquisition of Alleyton water/wastewater facility	<u>\$ -</u>	<u>\$ 2,446</u>

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

LOWER COLORADO RIVER AUTHORITY

NOTES TO FINANCIAL STATEMENTS

1. Significant Accounting Policies

Reporting Entity: The Lower Colorado River Authority (LCRA) is a conservation and reclamation district created by the Texas Legislature in 1934. It receives no state tax money and cannot levy taxes. It operates on revenues from the sale of wholesale electricity, water and other services. The LCRA Board of Directors (Board) is appointed by the governor of the state of Texas, with Senate approval, to serve six-year terms. The financial condition of LCRA is not controlled by or dependent on the State or any other political subdivision. Under the criteria set forth in Governmental Accounting Standards Board (GASB) Statement No. 14, "The Financial Reporting Entity," LCRA considers its relationship to the state to be that of a related organization.

GenTex Power Corporation: The GenTex Power Corporation (GenTex), a nonprofit corporation and wholly owned affiliate of LCRA, is governed by a nine-member board appointed by the LCRA Board. GenTex owns a 500-MW gas-fired combined cycle generating unit that began commercial operation in June 2001.

In FY 2000, LCRA entered into an agreement with a public company to jointly construct the generating unit. Each entity had an undivided 50 percent interest in the generating unit. In FY 2004, GenTex purchased the other entity's 50 percent share.

GenTex's share of the initial construction costs of the facility was entirely funded by an LCRA economic development grant. GenTex entered into contracts with LCRA's wholesale customers to sell energy to the customers at a price recovering only operating expenses, excluding depreciation, over the life of the plant. The contracts provide the customers the right of first refusal to purchase the facility and obtain half interest at a price of \$975 per customer. Since the initial cost of the facility was funded by an economic development grant provided by LCRA, there is no debt service to recover, and the expected cash flows are intended to recover only the operating costs. The plant is included in the Balance Sheets at the contractual value plus the purchase price of the 50 percent interest acquired in 2004.

Although it is a separate legal entity, GenTex is reported as part of LCRA because its sole purpose is to provide energy to LCRA's 43 long-term wholesale customers in meeting their demands and operating in a competitive market.

LCRA Transmission Services Corporation (LCRA TSC): LCRA TSC was created under the Texas Non-Profit Corporation Act under the Development Corporation Act of 1979. Although it is a separate legal entity, LCRA TSC is reported as part of LCRA because it is governed by a board of directors that is composed in its entirety of the LCRA Board of Directors.

Fayette Power Project: LCRA's coal-fired generating units are located at the Fayette Power Project (FPP) and operate pursuant to a participation agreement with the City of Austin (Austin). LCRA has an undivided 50 percent interest in Units 1 and 2 and wholly owns Unit 3. LCRA's investment is financed with LCRA funds, and its pro-rata share of operations is recorded as if wholly owned. The original cost of LCRA's share of FPP's generation and transmission facilities is recorded in the utility plant accounts of LCRA in accordance with its accounting policies. The equity interest in FPP is calculated pursuant to the participation agreement and is reported in various asset and liability accounts within LCRA's financial statements.

Basis of Accounting: The accompanying financial statements of LCRA, a governmental entity, have been prepared using proprietary fund and accrual basis accounting. LCRA implements all applicable GASB pronouncements and all applicable Financial Accounting Standards Board (FASB) pronouncements that do not conflict with or contradict GASB pronouncements. LCRA's accounts are maintained in accordance with the Federal Energy Regulatory Commission's Uniform System of Accounts. The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements, and reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

LCRA considers electric revenues and costs that are directly related to the generation, purchase, transmission and distribution of electricity to be operating revenues and expenses. Water and wastewater revenues and other services related to environmental laboratory operations, licensing and recreation, and the costs directly related to these services, are also considered operating revenues and expenses. Revenues and expenses related to financing and other activities are reflected as non-operating.

Issued But Not Yet Effective Pronouncements: In December 2007, the FASB issued Statement No. 141 Revised, "Business Combinations." This statement addresses the treatment of assets and liabilities acquired in a business combination. The new standard requires the acquiring entity to recognize all (and only) the assets acquired and liabilities assumed in the transaction; establishes the acquisition-date fair value as the measurement objective for all assets acquired and liabilities assumed; and requires the acquirer to disclose to financial statement users all of the

LOWER COLORADO RIVER AUTHORITY NOTES TO FINANCIAL STATEMENTS

information they need to evaluate and understand the nature and financial effect of the business combination. This statement is effective for LCRA beginning in FY 2009. The implementation of this FASB statement is not expected to have a material effect on the LCRA's financial position, results of operations or cash flows.

In September 2006, the FASB issued Statement No. 157, "Fair Value Measurements". This Statement defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles (GAAP), and expands disclosures about fair value measurements. This Statement applies under other accounting pronouncements that require or permit fair value measurements. This statement is effective for the LCRA's financial assets and liabilities beginning in FY 2009. FASB Staff Position No. FAS 157-2 delays the effective date for Statement No. 157 for nonfinancial assets and liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis, to fiscal years beginning after November 15, 2008. Therefore, this statement is effective for the LCRA's nonfinancial assets and liabilities beginning in FY 2010. The implementation of this FASB statement is not expected to have a material effect on the LCRA's financial position, results of operations or cash flows in FY 2009. If there are any conflicts with this Statement's requirements and any current or future GASB guidance regarding fair value measurements, LCRA will follow the requirements of the GASB.

In May 2008, the FASB issued Statement No. 162, "The Hierarchy of Generally Accepted Accounting Principles". This statement identifies the sources of accounting principles and the framework for selecting the principles to be used in the preparation of financial statements that are presented in conformity with GAAP. The LCRA plans to adopt Statement No. 162 when it becomes effective. The adoption of this statement is not expected to have a material effect on the LCRA's financial position, results of operations or cash flows.

Newly Adopted Standards for FY 2008: *GASB Statement No. 45, "Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions."* This Statement establishes standards for the accrual basis of measurement and recognition of postemployment benefits other than pensions (OPEB) expense over a period that approximates employees' years of service. In addition, the Statement provides information about actuarial accrued liabilities associated with OPEB plans and whether and to what extent progress is being made in funding the plans. GASB No. 45 disclosures are in Note 5, "Other Postemployment Benefits".

GASB Statement No. 49, "Accounting and Financial Reporting for Pollution Remediation Obligations." This Statement identifies the circumstances under which a government entity would be required to report a liability related to pollution remediation. The guidance defines when to recognize a liability for the cost of pollution remediation in the financial statements and how to measure the amount of the liability. The suggested method to value the liability is the "expected-cash-flows" technique. The implementation of GASB 49 did not have a material effect on the LCRA's financial position, results of operations, or cash flows.

GASB Statement No. 50, "Pension Disclosures." The Statement amends pension disclosures. The Statement more closely aligns current pension disclosure requirements with recently issued other postemployment disclosure requirements. Generally, the Statement requires disclosures regarding the funding status of governments' pension plans and contribution rates. Pension disclosures can be found in Note 4, "Retirement and 401(K) Plan Benefits."

Major Customers and Electric Revenues: Sales of electricity to LCRA's three major customers represented approximately 42 percent of total electric revenue for FY 2008 and 44 percent for FY 2007. No other customer accounts for more than 25 percent of LCRA's total electric revenues in FY 2008.

Electric revenues represented approximately 94 percent of LCRA's operating revenues for both FY 2008 and FY 2007.

ERCOT Settlements Reporting: LCRA reports power balancing transactions, which represent wholesale purchases and sales of power for real-time balancing purposes as measured in 15 minute intervals. These purchases and sales with ERCOT, as the balancing energy clearinghouse agent, are reported net. These amounts have historically represented a net purchase of power to LCRA; however, during FY 2008 and FY 2007 major components of these amounts resulted in net sales of power and ancillary services. These amounts are classified as electric revenues. The amounts included in electric revenues were \$41.3 million for FY 2008 and \$39.1 million for FY 2007.

Restricted Funds: Restricted funds consist of construction funds derived from debt issues, system revenues that have been designated for specific purposes by the Board and other funds with legal or contractual constraints.

Utility Plant: Utility plant consists of generating plants, electric transmission and distribution facilities, dams, reservoir land, natural gas production and development, irrigation systems, water and wastewater treatment facilities,

LOWER COLORADO RIVER AUTHORITY NOTES TO FINANCIAL STATEMENTS

telecommunications facilities, and related projects under construction. These assets are recorded at cost, which includes materials, labor, overhead, and interest capitalized during construction. The costs of repairs and minor replacements are charged to operating expense as incurred. Costs of asset replacements and betterments are capitalized. The cost of depreciable plant retired, along with removal expense less salvage value, is charged to non-operating expense on the Statement of Revenues, Expenses and Changes in Equity. Gains and losses upon disposition are recorded in the period incurred.

Water Rights: Water rights are stated at cost, net of accumulated amortization of \$7.4 million as of June 30, 2008 and 2007. Beginning in FY 2003, in accordance with accounting and reporting requirements, water rights are no longer being amortized but are evaluated annually to determine whether they are impaired and whether an indefinite life is reasonable.

Inventories: Coal is recorded at cost using the last-in, first-out method. Stored natural gas, fuel oil, and materials and supplies are stated at average cost. All non-fuel inventories are stated at the lower of cost or market.

Investments: LCRA's investments are stated at fair value. Any changes, unrealized and realized, in the fair value of financial investments are recorded as investment income.

Refunding and Defeasance of Debt: For debt refunding, the difference between the reacquisition price and the net carrying amount of the old debt is deferred and reported as a deduction from or an addition to the debt liability. For debt defeasances, the difference between the carrying amount of the debt and the amount of funds needed to retire the debt is recognized immediately in the Statements of Revenues, Expenses and Changes in Equity as a special item in FY 2007, but as interest expense in FY 2008. Prior to FY 2008, debt defeasances were reported as a special item because they were infrequent in nature and under the control of management. As of FY 2008, the LCRA has defeased debt in each of the last three fiscal years, and as such debt defeasances are no longer infrequent and are not required to be reported as a special item.

Compensated Absences: LCRA records earned vacation leave as a liability and accrues for certain salary-related expenses associated with the payment of compensated absences.

Rates and Regulations: LCRA's electric, water and wastewater rates are set by LCRA's Board at a level sufficient to recover its operating costs, debt service and debt service coverage requirements. LCRA's bond counsel is of the opinion that a Texas court applying Texas law would ultimately conclude that LCRA's Board has the authority to establish and collect such fees and charges. LCRA's transmission service rates remain regulated by the Public Utility Commission of Texas (PUC). While the LCRA Board has original jurisdiction over its water and wastewater rates, the Texas Commission on Environmental Quality has appellate jurisdiction.

Senate Bill (SB) 7, passed by the Texas Legislature in 1999, provided for retail electric open competition to begin in January 2002, continued electric transmission open access, and fundamentally redefined and restructured the Texas electric industry. Under SB 7, LCRA has structurally unbundled its electric generation business and assets from its electric transmission business and assets. SB 7 also allows retail customers of investor-owned utilities, as well as the retail customers of those municipally owned utilities and electric cooperatives that elect to participate in retail competition, to choose their electric supplier.

The greatest potential impact on LCRA from SB 7 could result from actions of its wholesale electric customers. If LCRA's larger wholesale electric customers open their territories to retail competition, there is a potential that such customers could lose end-user customers to other retail electric providers resulting in a reduced electric load, thus reducing the requirements served by LCRA under the existing wholesale power agreements. On the other hand, if LCRA's wholesale electric customers are successful in retaining existing customers and in growing their customer base, requirements served by LCRA under the existing wholesale power agreements could increase.

Transmission rates within the Electric Reliability Council of Texas (ERCOT) system are determined pursuant to a universal 100 percent "postage stamp" rate that spreads the total annual costs of transmission services among distribution service providers (DSPs) according to their electric loads. The transmission costs are determined pursuant to transmission cost of service (TCOS) rate proceedings required to be filed by all transmission service providers (TSPs), including LCRA TSC. Every electric end-use consumer in the ERCOT system pays a portion of the total cost of maintaining a reliable statewide transmission system. Transmission charges are calculated by multiplying a DSP's share of the statewide electric load by the statewide "postage stamp" rate of each transmission service provider. The load shares and rates are determined by the PUC through its TCOS regulatory process. Additionally, pursuant to a tariff approved by the PUC, LCRA TSC collects revenues for transformation services, providing transformers that "step

LOWER COLORADO RIVER AUTHORITY NOTES TO FINANCIAL STATEMENTS

down” voltage from levels appropriate for transmission to lower levels for distribution. A monthly charge for each transformation delivery point is also authorized under the transformation tariff. LCRA TSC also collects monthly metering service revenues based on a per meter charge according to the PUC approved tariff.

FY 2007 transmission revenues of \$169 million are the result of rate changes authorized during FY 2007. The predominant rate of \$2.88 per kW was in place from Sept. 21, 2006 through June 30, 2007. LCRA TSC filed an interim update of wholesale transmission rates with the PUC on July 25, 2006. The filing, Docket No. 32987, was approved by the PUC Commissioners on Sept. 21, 2006. The approved rate was \$2.88 per kW, effective as of Sept. 21, 2006.

FY 2008 transmission revenues of \$180.2 million are the result of rate changes authorized during the fiscal year. The predominant rate of \$3.02 was in place from Oct. 2, 2007 through April 19, 2008. LCRA TSC filed an interim update of wholesale transmission rates with the PUC on July 23, 2007, and the PUC Commissioners approved the new rate of \$3.02 per kW on Oct. 2, 2007. On Nov. 15, 2007 LCRA TSC filed a wholesale transmission rate case with the PUC and the PUC Commissioners approved the new rate of \$3.51 effective April 20, 2008. LCRA TSC filed an interim update of wholesale transmission rates with the PUC on July 25, 2008.

Regulatory Assets and Liabilities: LCRA applies the accounting requirements of FASB Statement of Financial Accounting Standards No. 71 (SFAS 71), “Accounting for the Effects of Certain Types of Regulation.” Accordingly, certain costs may be capitalized as a regulatory asset that would otherwise be charged to expense. A regulatory asset is recorded when it is probable that future revenue in an amount at least equal to the capitalized costs will result from inclusion of those costs in future rates. In addition, rate actions of the regulator may impose a liability on LCRA. A regulatory liability occurs when a regulator requires refunds to customers or provides current rates intended to recover costs that are expected to be incurred in the future. Any regulatory asset is amortized over the life of LCRA’s outstanding long-term debt, while a regulatory liability is recognized and charged to income when the associated costs are incurred. LCRA’s regulatory assets amounted to \$262.3 million and \$228.6 million at June 30, 2008 and 2007, respectively. Regulatory liabilities amounted to \$0.8 million and \$1.2 million at June 30, 2008 and 2007, respectively. The regulatory assets, which are included under deferred charges, consist of depreciation of debt-funded assets and costs related to outstanding debt. Debt-funded costs are deferred pending future recovery through the inclusion of the related debt service in rates. Regulatory liabilities are included in deferred credits and other long-term liabilities.

For the last three years, LCRA has been engaged with its electric wholesale customers in negotiations for the extension of their long-term power supply contracts. Thirty of LCRA’s existing customers, representing approximately 30 percent of its load, have entered into amended and restated contracts that extend to 2041. LCRA continues to be involved in ongoing negotiations with remaining customers to define their long-term relationship and develop terms of a contract extension.

LCRA has reviewed and will continue to monitor the relevance of SFAS 71 in light of SB 7 and future changes in the Texas electric industry. As of June 30, 2008, and for the foreseeable future, management believes that SFAS 71 will continue to apply and anticipates no material losses from the write-off of regulatory assets.

Capitalized Interest: Interest that is financed by debt proceeds is capitalized as part of the cost of capital assets and deferred charges. During FY 2008 and FY 2007, LCRA capitalized \$12.3 million and \$17.8 million of interest, respectively.

Fuel Factor: Revenues from the sale of electricity include amounts collected through the fuel factor. LCRA records over- or under-recoveries of fuel costs including unrealized gains or losses on financial contracts entered into as part of its gas price management program, as a deferred asset or liability. These costs are a component of the fuel factor. Over-recoveries may result in refunds to customers and, correspondingly, under-recoveries may result in additional assessments to customers.

Gas Price Management: Spot prices for natural gas ranged from \$5 to more than \$13 per mmBtu in FY 2008. In an effort to mitigate the financial and market risk associated with these price fluctuations, LCRA enters into futures contracts, swaps and options for energy price risk management purposes. Derivative instruments are recorded on the balance sheet at their fair value. Changes in the fair value of derivatives are recorded each period in current earnings. LCRA is using mark-to-market accounting as a component of the fuel factor for its derivatives, and gains and losses related to the financial contracts are recognized in current earnings.

Natural Gas Development and Production: LCRA has adopted the full-cost method of accounting for natural gas development and production. Under this method, all costs directly associated with acquisition and

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development of oil and gas properties are capitalized and depleted to expense over the life of proved reserves on a units-of-production method. For the years ended June 30, 2008 and 2007, depletion expense totaled approximately \$0.4 million, respectively.

Contract Extension Settlement with Major Customers: According to the terms of a 1987 settlement with two major customers, their wholesale power contracts were extended to 2016, and in return, LCRA reimbursed the customers for their costs incurred in planning generating facilities. These costs are amortized over the period affected by the contract extension.

Impairment: LCRA evaluates the carrying value of its property, plant and equipment, and other long-lived assets when major events or changes in circumstances indicate a decline in an asset's service capacity. Impairment is measured using methods that isolate the asset's service capacity that has been rendered unusable.

Depreciation, Depletion and Amortization: LCRA depreciates its plant in service on a straight-line basis over the estimated useful lives of the various classes of these assets. Annual depreciation expense, expressed as a percentage of depreciable plant, was approximately 3 percent for both FY 2008 and FY 2007. Depreciation, depletion and amortization expense for FY 2008 and 2007 was \$122.2 million and \$112.6 million, respectively.

The estimated useful life of property, plant and equipment by major category is as follows:

Hydraulic Production Plant	20 - 100 years
Steam Production Plant	25 - 40 years
Transmission Plant	35 - 65 years
General Plant	4 - 45 years
Irrigation Plant	15 - 75 years
Sewage and Water Treatment Plant	10 - 50 years
Telecommunication Facilities	10 - 25 years

Periodically, LCRA reviews the useful lives of depreciable assets. Changes in useful lives are accounted for as a change in accounting estimate in accordance with Statement of Financial Accounting Standard No. 154, *Accounting Changes and Error Corrections*. In FY 2008, a change in the estimated life of certain transmission capital assets was necessitated by related technological advances and construction material used. The change in the estimated lives of these assets increased depreciation and amortization expense by \$0.75 million on the Statement of Revenues, Expenses and Changes in Equity for the year ended June 30, 2008 and could increase depreciation and amortization expense by up to \$3.0 million in each future year that those assets are still in service.

Water rights are not amortized but are evaluated annually to determine whether they are impaired and whether an indefinite life is reasonable. Gains or losses created by refunding transactions are amortized over the shorter of the remaining terms of the new issues or the refunded bonds. Amortization of debt discount and premium is computed using the interest method over the life of the related bond issues. Amortization of debt issue cost is computed on the straight-line method over the life of the related bond issues, which approximates the interest method. Other deferred charges are amortized on a straight-line basis ranging from 20 to 40 years.

Statements of Cash Flows: All highly liquid investments (including investments in restricted funds) with an original maturity of 90 days or less are considered cash equivalents.

Reclassification: Certain amounts in the prior year's financial statements have been reclassified to conform to current year presentation.

LOWER COLORADO RIVER AUTHORITY

NOTES TO FINANCIAL STATEMENTS

2. Financial Instruments

As of June 30, 2008 and 2007, LCRA had the following investments and maturities:

Investments	June 30, 2008		June 30, 2007	
	Market Value ¹	WAM (Years) ²	Market Value ¹	WAM (Years) ²
Cash Equivalents				
U.S. Government Securities	\$ 4,986	0.18	\$ -	-
U.S. Agency Discount Notes	17,983	0.11	12,462	0.18
Commercial Paper	46,000	0.10	28,500	0.11
Money Market Fund	66,467	0.22	99,564	0.10
Investments				
U.S. Government Securities	134,084	1.24	188,728	0.98
U.S. Agency Discount Notes	25,891	0.46	4,897	0.48
Total	<u>\$ 295,411</u>	0.68	<u>\$ 334,151</u>	0.61

Cash and investments as of June 30, 2008 and 2007 consisted of the following:

Cash	\$ 908	\$ 1,193
Investments	295,411	334,151
Total Cash and Investments	<u>\$ 296,319</u>	<u>\$ 335,344</u>

¹ Dollars in Thousands

² Weighted Average Maturity

External Investments Pool: LCRA investments included a money market fund with TexPool at June 30, 2008 and 2007. The State Comptroller of Public Accounts oversees TexPool and the pool seeks to maintain a \$1 value per share as required by the Texas Public Funds Investment Act. There are no minimum balance requirements for TexPool participants, and there is no limit on the number of accounts per participant.

Interest Risk: LCRA has no formal policy to address exposure to fair value losses resulting from changes in interest rates. However, in accordance with management policy, LCRA manages its exposure to rising interest rates by investing a majority of its investment portfolio in securities with short-term maturities and holding investments to maturity.

Credit Risk: LCRA investment activities are governed by state statute (Public Funds Investment Act) which specifies the type and ratings of investments governmental entities are allowed to purchase. In addition, LCRA Board policy, internal operating procedures and applicable bond resolutions further restrict investment activity. At June 30, 2008 and 2007, LCRA investment in the investment pool (money market) was rated AAAM by Standard & Poor's. Investments in commercial paper were rated A-1+ by Standard & Poor's and P-1 by Moody's Ratings. Investments in US Agencies were rated Aaa by Moody's Ratings.

Concentration of Credit Risk: As of June 30, 2008, LCRA had commercial paper representing 5.08 percent of LCRA investments from a single issuer. LCRA has no formal policy to limit the amount that may be invested in any one issuer. The Public Funds Investment Act requires investments in commercial paper to be rated A-1, P-1, or an equivalent rating. However, LCRA's internal investment strategy requires higher commercial paper ratings of A-1+ or P-1, and management closely monitors the portfolio mix to provide diversity and limit concentration.

Estimation of Fair Value: The carrying amounts of receivables and certain other liabilities approximate market value due to the short maturity of these instruments. The estimated market value of long-term debt, based on current market yields was \$2.9 billion and \$2.7 billion at June 30, 2008 and 2007, respectively.

Hedging Instruments: LCRA's gas activities subject LCRA's earnings to variability based on fluctuations in the market price of natural gas, as measured by changes in the delivered price of natural gas at various points in the system's natural gas grid. During FY 2008, spot prices for natural gas ranged from about \$5 to more than \$13 per mmBtu. In an effort to mitigate the financial and market risk associated with these activities for the customers, LCRA

LOWER COLORADO RIVER AUTHORITY NOTES TO FINANCIAL STATEMENTS

routinely enters into natural gas swaps, futures contracts and options for other than trading purposes. This use of these types of transactions for the purpose of reducing exposure to price risk is generally referred to as hedging, with the results matching the financial impact of these transactions with the cash impact resulting from consummation of the transaction being hedged. These contracts are commitments to either purchase or sell designated quantities of a commodity at a specified price and at a specified date. These contracts may be settled in cash or through delivery of the specified commodity; however, in general, LCRA settles futures contracts in cash. LCRA holds highly liquid contracts with terms ranging up to 18 months. Initial margin requirements, which are flat fees per contract, and daily margin calls are met in cash or short-term liquid government securities. The financial impact of these futures contracts, the effects of which were substantially offset by the physical gas purchases, was to recognize a gain of approximately \$15.5 million during 2008 and a loss of approximately \$3.7 million during 2007. Net income is not affected because this activity is a component of the fuel costs passed through to the customers and is included in the balance sheet fuel over- or under-recovery account.

All derivative instruments are recorded on the balance sheet at their fair value, which generally reflects the estimated amounts that LCRA would receive or pay to terminate the contracts. At June 30, 2008, LCRA held no hedging liabilities, and the fair value of LCRA's hedging assets was \$10.1 million. Changes in the fair value of the derivatives are recorded in current earnings as a component of the fixed-fuel factor. LCRA has not designated any of the derivatives as hedging instruments, as allowed by FASB 133.

Counterparties expose LCRA to credit-related losses in the event of nonperformance, but LCRA does not expect any counterparties to fail to meet their obligations, given their high credit ratings.

LOWER COLORADO RIVER AUTHORITY NOTES TO FINANCIAL STATEMENTS

3. Long-Term Debt

Changes during FY 2008 and FY 2007, of long-term debt, including current portions as follows (in thousands):

Series	May 15,		Balance June 30, 2006	Increase (Decrease)	Balance June 30, 2007	Increase (Decrease)	Balance June 30, 2008	Amount Due ⁽⁵⁾ in FY 2009
	From	To						
LCRA TSC 2003A (Auction Rate) ⁽¹⁾	2030	2032	\$ 50,000	\$	\$ 50,000	\$ (50,000)	\$ -	\$
LCRA TSC 2003B (5.00%-5.375%)	2009	2031	237,240	(7,690)	229,550		229,550	7,690
LCRA TSC 2003C (5.00%-5.25%)	2009	2033	125,560	(4,565)	120,995	(1,470)	119,525	4,515
LCRA TSC 2004 (3.00%-5.00%)	2009	2034	125,490	(8,255)	117,235		117,235	4,170
LCRA TSC 2005 (3.50%-5.00%)	2009	2035	126,095		126,095	(4,175)	121,920	4,190
LCRA TSC 2006 (4.50%-5.00%)	2009	2036	135,925	(4,270)	131,655		131,655	4,485
LCRA TSC 2006A (4.00%-5.00%)	2009	2036	-	133,585	133,585		133,585	4,490
LCRA TSC 2008 (5.00%-5.25%)	2011	2035	-		-	165,205	165,205	
LCRA 2008 (5.00%-5.75%)	2009	2037	-		-	195,960	195,960	3,560
LCRA 2006 (4.00%-5.00%)	2009	2036	80,305	(1,610)	78,695	(1,675)	77,020	1,760
LCRA 2004 (4.00%-5.00%)	2009	2029	100,300	(2,910)	97,390	(2,990)	94,400	3,065
LCRA 2004A (3.50%-3.50%) ⁽²⁾	2007	2007	90	(90)	-		-	
LCRA 2004D (3.00%-5.00%)	2009	2034	48,910	(830)	48,080	(840)	47,240	845
LCRA 2003 (3.25%-5.25%)	2009	2033	90,880	(8,905)	81,975	(4,225)	77,750	1,860
LCRA 2002 (3.50%-5.00%)	2009	2031	116,610	(1,580)	115,030	(2,725)	112,305	2,010
LCRA 2001A (5.00%-5.375%)	2009	2032	138,205	(3,540)	134,665	(3,035)	131,630	3,270
LCRA 2001 (5.00%-8.00%)	2009	2031	95,755	(735)	95,020	(1,350)	93,670	1,250
LCRA 1999A (5.50%-5.875%)	2014	2020	347,480		347,480	(565)	346,915	
LCRA 1999B (5.875%-6.00%)	2009	2014	348,450	(49,065)	299,385	(43,150)	256,235	58,710
LCRA 1999E (5.25%-5.75%)	2010	2011	20,655		20,655	(1,945)	18,710	
LCRA 1999F (5.50%-5.75%)	2010	2012	97,905		97,905	(11,520)	86,385	
LCRA 1999G (4.00%-4.85%) ⁽²⁾⁽³⁾	2008	2016	38,105	(2,125)	35,980	(2,400)	33,580	2,700
LCRA 1999H (3.20%-3.65%) ⁽²⁾⁽⁴⁾	2009	2011	4,265	(1,400)	2,865	(1,205)	1,660	950
LCRA 1999I (3.45%-4.15%) ⁽⁴⁾	2009	2020	3,430	(130)	3,300	(145)	3,155	165
LCRA TWDB Note Payable (6.05%-6.10%)	2020	2034	10,500		10,500		10,500	
LCRA TWDB Note Payable (5.58%-5.83%)	2022	2038	14,040		14,040		14,040	
Add: Unamortized Net Premium			35,593	(3,139)	32,454	11,918	44,372	1,030
Subtotal			\$ 2,391,788	\$ 32,746	\$ 2,424,534	\$ 239,668	\$ 2,664,202	\$ 110,715
Unamortized Net Losses on Refunded Debt			(246,216)	13,271	(232,945) ⁽⁶⁾	22,875	(210,070) ⁽⁷⁾	(14,867)
Taxable Commercial Paper (Variable Rate)			18,100	2,200	20,300	1,600	21,900	21,900
Tax-Exempt Commercial Paper (Variable Rate)			78,400	119,400	197,800	(56,600)	141,200	141,200
Total			\$ 2,242,072	\$ 167,617	\$ 2,409,689	\$ 207,543	\$ 2,617,232	\$ 258,948

(1) Auction Rate debt was redeemed in full on April 22, 2008.

(2) Represents yield rate of Capital Appreciation Bonds.

(3) Maturity Date is July 1.

(4) Maturity Date is January 1.

(5) Total amount due in FY 2008 is \$286.5 million.

(6) \$181,694 is associated with LCRA 1999 A-I refunding bonds and \$51,251 is associated with LCRA TSC 2003A and 2003B refunding bonds.

(7) \$167,986 is associated with LCRA 1999 A-I refunding bonds and \$42,084 is associated with LCRA 2003B refunding bonds.

LCRA's debt as of June 30, 2008, has been rated by Fitch, Moody's and Standard & Poor's, respectively, as follows:

FITCH, MOODY'S AND STANDARD & POOR'S

Refunding and Improvement Revenue Bonds: A+, A1 and A (Uninsured)

Commercial Paper: F-1+, P-1, A-1

LCRA Transmission Services Corporation Contract Refunding Revenue Bonds: A+, A2, A (Uninsured)

LCRA Transmission Services Corporation Commercial Paper: F-1+, P-1, A-1+

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Bond and note debt payments, excluding commercial paper, are as follows (in thousands):

Ending June 30	Principal	Interest	Total
2009	\$ 109,685	\$ 134,130	\$ 243,815
2010	113,230	129,927	243,157
2011	120,920	123,976	244,896
2012	127,215	117,467	244,682
2013	134,100	111,241	245,341
2014-2018	645,095	445,925	1,091,020
2019-2023	487,685	294,415	782,100
2024-2028	368,600	183,475	552,075
2029-2033	349,875	92,261	442,136
2034-2038	163,425	17,281	180,706
	<u>\$ 2,619,830</u>	<u>\$ 1,650,098</u>	<u>\$ 4,269,928</u>
Unamortized Net Premium	44,372		44,372
Total	<u>\$ 2,664,202</u>	<u>\$ 1,650,098</u>	<u>\$ 4,314,300</u>

New and Refunding Bonds: During FY 2008, LCRA issued \$1.6 million of taxable commercial paper and \$207.8 million of tax-exempt commercial paper. In addition, LCRA on behalf of LCRA TSC issued \$110.1 million of tax-exempt commercial paper.

During FY 2008, LCRA deposited funds into an escrow account to defease debt early. On January 3, 2008, LCRA defeased approximately \$2.5 million from LCRA Series 1999 A, 1999 B, 1999 E, 1999 F, 2001, 2002, 2003, and 2004 D bonds. Pursuant to the stipulations of the Revenue Bonds and in the opinion of LCRA's Bond Counsel, the repayment of these obligations constitutes a legal defeasance. These defeasances reduce future debt service requirements.

On April 22, 2008 LCRA TSC used \$50 million of tax-exempt commercial paper proceeds to refund \$50 million of TSCorp 2003A Auction Rate bonds.

On June 11, 2008, LCRA issued \$196 million of LCRA Refunding Revenue Bonds, Series 2008. The proceeds from the bond issuance were used to refund \$204.4 million of tax-exempt commercial paper. Also on June 11, 2008, LCRA on behalf of LCRA TSC issued \$165.2 million of LCRA Transmission Contract Revenue Bonds, Series 2008. The proceeds from the bond issuance were used to refund \$158.6 million of tax-exempt commercial paper which included the \$50 million issued to refund the TSCorp 2003A Auction Rate bonds.

During FY 2007, LCRA issued \$6.5 million of taxable commercial paper and \$95.9 million of tax-exempt commercial paper. In addition, LCRA on behalf of LCRA TSC issued \$165 million of tax-exempt commercial paper.

On December 6, 2006, LCRA on behalf of LCRA TSC issued \$133.6 million of LCRA Transmission Contract Refunding Bonds, Series 2006A. The proceeds from the bonds issuance were used to refund \$130 million of tax-exempt commercial paper.

During FY 2007, LCRA deposited funds into an escrow account to defease debt early. On January 18, 2007, LCRA defeased approximately \$5.1 million from LCRA Series 2001A and LCRA Series 2003. In addition, on April 26, 2007, LCRA on behalf of LCRA TSC defeased approximately \$19 million from the LCRA TSC Series 2003B, 2003C, 2004 and 2006 Contract Refunding Revenue Bonds. Pursuant to the stipulations of the Revenue Bonds and in the opinion of LCRA's Bond Counsel, the repayment of these obligations constitutes a legal defeasance. These defeasances reduce future debt service requirements.

The principal associated with the bonds that have been previously refunded by LCRA but remain outstanding at June 30, 2008 and 2007, totals \$329 million and \$368 million, respectively. Proceeds from these refunding bond issues were escrowed to purchase U.S. government obligations that will mature at such time and yield interest at such amounts so that sufficient monies are available for payment of principal, premium, if any, and interest on the refunded bonds when due. None of these refunded bonds are included in LCRA's outstanding long-term debt at June 30, 2008 and 2007.

Optional Redemption: The LCRA TSC Series 2008 bonds that mature on and after May 15, 2019, are redeemable at the option of LCRA, on May 15, 2018, or on any date thereafter, in whole or in part, in principal amounts of \$5,000 or integral multiples thereof (and, if in part, the particular Bonds or portion thereof to be redeemed shall be selected by LCRA in its sole discretion) at a redemption price equal to the principal amount of such bonds to be redeemed, plus accrued interest to the redemption date.

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redemption price equal to the principal amount of such bonds to be redeemed, plus accrued interest to the redemption date.

The Series 2001A bonds maturing on and after May 15, 2012, are redeemable at the option of LCRA, on May 15, 2011, or on any date thereafter, in whole or in part, in principal amounts of \$5,000 or integral multiples thereof at a redemption price equal to the principal amount of such bonds to be redeemed, plus accrued interest to the redemption date.

The Series 2001 bonds maturing on or after May 15, 2011, are callable at the option of LCRA for a period of one year beginning on May 15, 2010, at the price of 101 percent plus accrued interest. These bonds are also callable at LCRA's option on May 15, 2011, or on any date thereafter, in whole or in part, in principal amounts of \$5,000 or integral multiples thereof at the price of 100 percent plus accrued interest.

The Series 1999A bonds, Series 1999B bonds, Series 1999E bonds and Series 1999F bonds maturing on or after May 15, 2010, are callable at the option of LCRA for a period of one year beginning on May 15, 2009, at the price of 101 percent plus accrued interest. These bonds are also callable at LCRA's option on May 15, 2010, or on any date thereafter, in whole or in part, in principal amounts of \$5,000 or integral multiples thereof at the price of 100 percent plus accrued interest.

The LCRA bonds outstanding as of June 30, 2008 and 2007, are parity debt under the Master Resolution and are collateralized by a lien on and pledge of the Pledged Revenues. Pledged Revenues are defined to include all amounts received pursuant to Contractual Commitments and all lawfully available funds of LCRA. The LCRA Transmission Contract Revenue Bonds Series 2003B, 2003C, 2004, 2005, 2006, 2006A and 2008 are solely secured by the obligation of LCRA TSC to make Installment Payments to LCRA from the Net Revenues of LCRA TSC (subordinate to first lien on Gross Revenues securing the Purchase Price Payments under the Initial Contractual Commitment). Net revenues are defined as Gross Revenues less any Purchase Price Payments due to LCRA and less the Operating and Maintenance Expenses during the period.

Commercial Paper: LCRA is authorized to issue up to \$350 million in short-term tax-exempt obligations and \$350 million in short-term taxable obligations to provide system improvements, acquire fuel reserves and facilities, refund outstanding debt, and pay interest on outstanding debt. Outstanding notes were issued in denominations of \$100,000 or more with maturities of 270 days or less from their respective issue dates. The Commercial Paper programs expire May 15, 2020. It is management's intent to periodically renew outstanding commercial paper upon maturity, and to periodically convert the commercial paper balances to long-term bonds.

LCRA maintains credit facilities with banks that provide available borrowings sufficient to pay the principal of the notes. LCRA has entered into a revolving credit agreement with a bank that is obligated to lend LCRA amounts of up to \$287.5 million for the Tax-Exempt Series. Of the \$287.5 million, \$112.5 million of this agreement expires on Oct. 13, 2008, and the remaining \$175 million expired on June 27, 2008. LCRA extended the \$175 million revolving credit agreement for one year, expiring on June 26, 2009. LCRA has an additional revolving credit agreement with banks that are obligated to lend LCRA aggregate amounts of up to \$40 million for the Taxable Series. This agreement had an expiration date of Nov. 1, 2008, and has been renewed to Nov. 1, 2011. Failure by LCRA to meet certain restrictive covenants could result in the withdrawal of the banks' commitments for the unused lines of credit. There were no borrowings under any of the agreements as of June 30, 2008.

LCRA TSC is authorized to issue tax-exempt commercial paper notes in an aggregate amount of principal and interest not to exceed \$250 million under its commercial paper program. The commercial paper program expires on May 15, 2042. It is management's intent to periodically renew outstanding commercial paper upon maturity, and to periodically convert the commercial paper balances to long-term bonds.

LCRA TSC maintains credit facilities with banks that provide available borrowing sufficient to pay the principal and interest on the notes. A \$150 million credit agreement is available to pay \$137 million of principal and \$13 million of interest. This agreement expires on April 29, 2009. Another credit agreement of \$100 million is available to pay \$91 million of principal and \$9 million of interest. This credit agreement expired on August 27, 2008. Management did not renew the credit agreement. Failure by LCRA or LCRA TSC to meet certain restrictive covenants could result in the withdrawal of the banks' commitments for the unused line of credit. There were no borrowings under either credit facility agreement as of June 30, 2008.

Conduit Debt: At June 30, 2008, there are two series of Pollution Control Revenue Bonds outstanding with an aggregate principal amount payable of \$50 million. The bonds mature in April 2027 and 2030, \$25 million each year. The bonds were issued to finance the costs of acquiring, constructing and improving certain solid waste and sewage disposal facilities of a private-sector entity. LCRA executed an installment sale agreement with the entity whereby the proceeds of the bonds were used to finance a portion of the project. In turn, the entity agreed to make

LOWER COLORADO RIVER AUTHORITY NOTES TO FINANCIAL STATEMENTS

payments sufficient to pay, when due, the principal and interest on the bonds. The bonds do not constitute a debt or pledge of LCRA, and accordingly, have not been reported in the accompanying financial statements.

Mandatory Redemption: A number of LCRA's term bonds are subject to mandatory sinking fund redemption at the redemption price which equals the principal amount thereof plus accrued interest to the redemption date. The particular bonds or portions thereof to be redeemed are to be selected and designated by LCRA (provided that a portion of a Bond may be redeemed only in an integral multiple of \$5,000). The mandatory sinking fund redemption dates range from May 15, 2020 to May 15, 2037.

4. Retirement and 401(k) Plan Benefits

Retirement Plan: The Lower Colorado River Authority Retirement Plan (Plan) is a single-employer defined benefit pension plan and is administered by the LCRA Retirement Plan Board of Trustees. The Plan issues a stand-alone financial report that is available from the Board of Trustees. The Plan has received a favorable determination letter from the Internal Revenue Service and is exempt from federal income taxes, under the appropriate section of the Internal Revenue Code.

The Plan provides retirement, death and disability benefits. Employees are not required to contribute to the Plan although the Plan retains employee contributions and associated liabilities for years prior to April 1, 1984, when the Plan did require employee contributions. Amendments to the Plan are made only with the authority of the LCRA Board of Directors.

Effective January 1, 2002, the Plan was amended to provide cash balance benefit features. Active employees as of December 31, 2001, were given the opportunity to remain participants under the pension provisions (Retirement Program A) or to elect to become participants under the cash balance provisions (Retirement Program B). Employees hired prior to January 1, 2002, who elected Program A and who worked at least 1,000 hours per annum were eligible plan participants in the Plan upon completion of six months of service and become 100 percent vested after three complete years of service. Any employee who was employed by LCRA prior to January 1, 2002, and who elected Program B was eligible to participate in the cash balance benefit plan as of January 1, 2002, and became 100 percent vested after three complete years of service. Any employee hired after January 1, 2002, who works at least 1,000 hours per annum is automatically enrolled in Program B and is eligible to participate in the Plan after three consecutive months of service and is 100 percent vested after three complete years of service.

Under Program A, employees may retire with unreduced accrued benefits at age 65 with five years of service, or when the total of their age and service equals 80. Retirement benefits are based on years of service and salary levels at retirement. Under Program B, the value of the employee's account will be adjusted by increasing the balance by 4 percent of the employee's compensation paid per year. The value of the account earns an annual interest rate of 7 percent. The retirement benefit for an employee who has reached his or her normal retirement date is a single lump sum payment equal to the participant's accrued balance or monthly payments as provided by the Plan.

Funding Policy: The LCRA makes annual contributions to the plan that are actuarially determined as of each valuation date and consist of a normal cost contribution and an amortization of the unfunded actuarial accrued liability (UAAL) using the entry age normal actuarial cost method. In FY 2008, LCRA began a fixed rate funding policy for the Plan under which LCRA will contribute 9.7 percent of biweekly payroll for 10 fiscal years and 5.7 percent thereafter toward funding its pension plan. The rates are meant to fund the plan's normal cost and to amortize the plan's UAAL, which at April 1, 2007 was \$107.6 million, over a reasonable period time.

The UAAL contribution amount is based on amortization of \$51.2 million, as of July 1, 2007, of the UAAL over 10 year using a level percentage of payroll method on a close basis and amortization of the remaining UAAL, \$56.4 million, over 21 years using a level percentage of payroll method on an open basis. Because actual expense may differ from actuarial assumptions, the amortization period for the remainder of the UAAL may be longer or shorter than the expected 21 years. The total weighted average amortization period for the total UAAL is 16.2 years as of the April 1, 2008 valuation date. The costs of administering the Plan are paid by the Plan and are considered in the determination of the required employer contribution rate.

Annual Pension Cost: The required contribution was determined as of the April 1, 2007 actuarial valuation using the entry age normal actuarial cost method. The original actuarial assumptions included (a) 7.75 percent investment rate of return, net of administrative expenses and (b) projected salary increases of 4.5 percent to 12.5 percent varying by entry age group and attained age. Both (a) and (b) reflect an inflation component of 4 percent.

**LOWER COLORADO RIVER AUTHORITY
NOTES TO FINANCIAL STATEMENTS**

Schedule of Funding Progress

Actuarial Valuation Date	(1) Actuarial Value of Assets ²	(2) Actuarial Accrued Liability Entry Age	(3) Funded Ratio (1)/(2)	(4) Unfunded Actuarial Accrued Liability (2)-(1)	(5) Annual Covered Payroll ¹	(6) Unfunded Actuarial Accrued Liability as a Percentage of Covered Payroll (4)/(5)
April 1, 2006	\$ 269,195,679	\$ 382,758,278	70.3	\$113,562,599	\$ 143,978,576	78.9
April 1, 2007	296,039,961	403,626,660	73.3	107,586,699	147,840,508	72.8
April 1, 2008	317,407,521	426,749,406	74.4	109,341,885	153,614,048	71.2

¹ Based on projected payroll as of valuation date.

² Actuarial value approximates market value.

Three-Year Annual Pension Cost (APC) Trend Information

<u>Fiscal Year Ending</u>	<u>APC</u>	<u>Percentage of APC Contributed</u>	<u>Net Pension Obligation (NPO)¹</u>
June 30, 2006	\$14,268,341	100%	\$ -
June 30, 2007	16,700,651	100	-
June 30, 2008	15,286,276	100	-

¹ NPO is zero since employer contributions have been equivalent to actuarially determined funding requirements for all fiscal years beginning December 15, 1986.

401(k) Plan: LCRA's Retirement Benefits Board of Trustees administers this single-employer defined contribution plan. The plan is accounted for on the accrual basis and all assets are recorded at fair value. The plan offers the choice of making pretax contributions, Roth (after taxes) contributions or a combination of both. The plan has received a favorable determination letter from the Internal Revenue Service and is exempt from federal income taxes, under the appropriate section of the Internal Revenue Code.

Employees are eligible to participate in the plan immediately upon employment. Eligible employees who elect to participate in the plan may contribute a minimum of 1 percent of their annual compensation, not to exceed \$15,500 in 2008. Employees age 50 or over may contribute an additional \$5,000 in 2008. Effective January 1, 2002, employees under Program A of the Pension Plan receive an LCRA matching contribution equal to 25 percent of the first 4 percent of compensation that the employee had elected to contribute to the plan. Under Program B of the Pension Plan, LCRA provides matching contributions equal to 100 percent of the first 4 percent of compensation and 50 percent of the next 2 percent of compensation that the employee has elected to contribute to the plan. Contributions made by both the employer and employee are vested immediately. Amendments to the Plan are made only with the authority of the LCRA Board.

Contributions by the LCRA and the employees for the years ended June 30, 2008 and 2007 are presented below:

	<u>2008</u>	<u>2007</u>
	<i>(Dollars in Thousands)</i>	
Employer contributions	\$3,000	\$2,627
Employee contributions	\$9,896	\$9,329

**LOWER COLORADO RIVER AUTHORITY
NOTES TO FINANCIAL STATEMENTS**

5. Other Postemployment Benefits

Plan Description: The LCRA Employees' Post Retirement Health Benefits Program (OPEB Plan) is a single-employer defined benefit healthcare plan administrated by the LCRA Board of Directors (Board). The OPEB Plan provides postemployment healthcare benefits to retirees and terminated employees eligible for such benefits. The OPEB Plan does not issue a stand-alone financial report. Amendments to the OPEB Plan are made only with the authority of the Board.

In FY 2008, LCRA implemented GASB Statement No. 45 "Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions". Prior to GASB Statement No. 45, governments reported the cost of other postemployment benefits (OPEB) on a "pay-as-you-go" basis. The annual cash paid for these benefits was the annual expense. Under GASB Statement No. 45, state and local government employers must account for, and report, the annual cost of the OPEB in the same way they report costs related to pensions. As a result, the annual OPEB cost for government employers is based on an actuarially determined contribution amount rather than on the "pay-as-you-go" method.

Funding Policy: The LCRA funding policy pays only for current cost premiums. LCRA contributes a portion of health plan premiums for retirees, but makes no contribution for terminated employees. LCRA may contribute up to 75 percent of the total healthcare plan premium amount (cost share amount) depending on the retiree's retirement option choice (see note 4). For option A retirees, LCRA contributes 100 percent of the cost share amount. For option B retirees, LCRA may contribute 25, 50, 75 or 100 percent of the cost share amount based on the retiree's length of service

Annual OPEB Cost and Net OPEB Obligation: The Annual Required Contribution (ARC) to the OPEB Plan is actuarially determined as of each valuation date. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover the normal cost each year and amortize any unfunded actuarial liabilities over a period not to exceed 30 years. In FY 2008, the ARC is equal to the OPEB annual expense (OPEB Cost). For the fiscal year, the LCRA funding policy paid only for current cost share premiums, which means no assets were set aside for future benefits. Therefore, a net OPEB obligation exists at year-end. The following represents the OPEB Cost for the year, the amount paid and changes in the net OPEB obligation for FY 2008:

Annual required contribution (OPEB Cost)	\$10,262,376
Contributions made	<u>5,105,185</u>
Increase in net OPEB obligation (asset)	5,157,191
Net OPEB obligation (asset) – Beginning of year	<u>-</u>
Net OPEB obligation (asset) – End of year	<u>\$5,157,191</u>

LCRA annual OPEB cost, the percentage of the annual OPEB cost contributed, and the net OPEB obligation for FY 2008 were as follows:

Fiscal Year Ended	Annual OPEB Cost	Percentage of Annual OPEB Cost Contributed	Net OPEB Obligation
6/30/2008	\$10,262,376	50%	\$5,157,191

This schedule only contains information for FY 2008, as this is the year of GASB No. 45 implementation.

Funded Status and Funding Progress: As of July 1, 2007, the actuarial accrued liability (AAL) for benefits was \$170,075,954 with no actuarial value of assets, resulting in an unfunded actuarial accrued liability (UAAL) of \$170,075,954. The covered payroll (annual payroll of active employees covered by the plan) was \$138,863,719, and the ratio of the UAAL to the covered payroll was 122.5 percent. The Schedule of Funding Progress, presented below, is designed to present multiyear trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liabilities for future benefits. The schedule only contains information for FY 2008 as this is the year of GASB Statement No. 45 implementation.

LOWER COLORADO RIVER AUTHORITY NOTES TO FINANCIAL STATEMENTS

Actuarial Valuation Date	(1) Actuarial Value of Assets	(2) Actuarial Accrued Liability Entry Age	(3) Funded Ratio (1)/(2)	(4) Unfunded Actuarial Accrued Liability (2)-(1)	(5) Annual Covered Payroll ¹	(6) Unfunded Actuarial Accrued Liability as a Percentage of Covered Payroll (4)/(5)
July 1, 2007	\$ -	\$170,075,954	0.00%	\$170,075,954	\$138,863,719	122.5%

¹ Based on projected payroll as of valuation date.

Actuarial Methods and Assumptions: Actuarial valuations of an ongoing plan involve estimates of the value of reported amounts and assumptions about the probability of events far into the future. Examples include, but are not limited to, assumptions about future employment, mortality and future healthcare costs. Actuarially determined amounts are subject to periodic revisions as actual results are compared with past expectations and new estimates are made about the future.

Projections of benefits for financial reporting purposes are based on the substantive plan (the plan as understood by the employer and the plan members), the included types of benefits provided at the time of each valuation and the historical pattern of sharing of benefit costs between the employer and plan member to that point. Actuarial calculations reflect a long-term perspective. Consistent with that perspective, the actuarial methods and assumptions used include techniques that are designed to reduce short-term volatility in actuarial accrued liabilities and the actuarial value of assets.

In the April 1, 2007 actuarial valuation the Entry Age Normal cost method was used. The actuarial assumptions included a 5 percent discount rate, a 4 percent inflation rate and a projected annual healthcare cost trend rate of 11 percent for FY 2008 reduced by decrements of 1 percent to an ultimate rate of 6 percent after five years. The UAAL is being amortized on an open basis as a level 4.37 percent of projected payroll over a thirty year amortization period.

6. Commitments and Contingencies

Construction: LCRA's construction budget provides for capital improvement projects with cash requirements through FY 2013 of approximately \$2.7 billion, including \$468.6 million in FY 2009.

LCRA's forecasted capital program includes LCRA's share of the remaining cost of SO₂ scrubbers for two coal-fired generating units jointly owned by LCRA and the City of Austin. The scrubbers must be installed by October 2012, under the provisions of a flexible air quality permit received from the Texas Commission on Environmental Quality in 2002.

LCRA's forecasted capital program also includes Phase 2 of the Peaker Project for equipment purchase, detailed engineering, construction, and commissioning. The peaker project should be completed in FY 2009. The objective of the project is to add peaking capacity to LCRA's system that will offset costs and risks associated with increasing dependence on market purchases to meet peak demand. The new peaking capacity will reduce cost to LCRA's wholesale customers by being available to generate during periods of peak energy prices.

Finally, LCRA's forecasted capital program also includes \$211.4 million for the Clear Springs/Zorn-Hutto Project. The LCRA Transmission Services Corporation (LCRA TSC) is proposing to build a new 345-kilovolt double-circuit transmission line. The proposed project, in conjunction with another transmission line project being constructed by TXU Electric Delivery (TXU ED) north of the Hutto switching station, will address several regional transmission needs and has been recommended by the Electric Reliability Council of Texas (ERCOT).

Sandy Creek Project: LCRA has signed an agreement to participate as a power purchaser and equity partner in the Sandy Creek Energy Station, a coal electric generation plant located near Waco, Texas. The facility has received an air permit from the Texas Commission on Environmental Quality and other necessary permits. The unit is under construction and scheduled to be operational in 2012. LCRA associated capital expenses are included in LCRA's construction budget. LCRA's purchases of power from the facility are expected to begin in FY 2013 and are estimated to be approximately \$60 – 70 million annually.

Leases: LCRA leases and operates certain transmission facilities and equipment owned by 11 of LCRA's wholesale customers. The leases are the basis for LCRA to provide the same service to all of its customers and for

LOWER COLORADO RIVER AUTHORITY NOTES TO FINANCIAL STATEMENTS

the cost of such service to be shared by all customers on a consistent basis. Payments for the leased facilities vary from year to year and are based on the original cost of the facilities, adjusted for depreciation, and are updated annually to reflect additions, retirements and depreciation. The terms of the leases are perpetual, but may be terminated by LCRA or the lessors upon five years written notice. In addition, LCRA leases towers and related space to provide shared communications with 26 public entities and leases a portion of its office facilities. LCRA has leases totaling approximately \$14.6 million in FY 2008. Leases associated with transmission facilities comprise approximately 78 percent of total LCRA leases for FY 2008.

The following is a schedule by years of current and future minimum rental payments required under these operating leases for the remaining non-cancellable lease terms as of June 30, 2008 (in thousands).

Fiscal Year	Minimum Lease Payments
2008	\$14,635
2009	14,675
2010	14,863
2011	14,496
2012	12,769
2013	12,991

Coal and Rail Contracts: For FY 2009 approximately 47 percent of the fuel requirements for the Fayette Power Project Units 1 and 2 (FPP 1 & 2) will be supplied by two multi-year contracts with mines in Wyoming. The first contract, which ends in the second quarter of FY 2008, will provide coal at a fixed price for its entire term with a fixed volume for each calendar year. The second contract which ends in the second quarter of FY 2010 will provide coal at a separate fixed price per year with a fixed volume for its entire term. Starting in the third quarter of FY 2009, two new multi-year contracts will supply part of FPP 1 & 2's fuel requirements. These new multi-year contracts each have separate fixed prices per calendar year and an annual fixed volume for the entire term. During FY 2008 and 2007, LCRA's share of FPP 1 & 2's multi-year contract purchases totaled \$14.4 million and \$18.7 million, respectively.

For FY 2009 approximately 44 percent of the fuel requirements for Fayette Power Project Unit 3 (FPP 3) will be supplied by two multi-year contracts with mines in Wyoming. The first contract, which ends in the second quarter of FY 2009, will provide coal at a separate fixed price per year with a fixed volume for each calendar year. The second contract which also ends in the second quarter of FY 2009 will provide coal at a fixed price for its entire term with a fixed volume for each calendar year. Starting in the third quarter of FY 2009, one new multi-year contract will supply part of FPP 3's fuel requirements. The new multi-year contract has a separate fixed price per year and an annual fixed volume. During FY 2008 and 2007, LCRA's multi-year contract purchases totaled \$20.3 million and \$12.6 million, respectively.

LCRA and Austin Energy have a multi-year transportation contract with one rail carrier to ship Powder River Basin coal to all three units at FPP. FPP committed to ship a specific, minimum volume of coal from the Powder River Basin under a common carrier tariff with a second rail carrier. Freight costs incurred by LCRA were approximately \$95.8 million and \$48.3 million in FY 2008 and FY 2007, respectively.

Natural Gas: LCRA has several long-term contracts to provide a portion of the natural gas requirements to its gas-fired generation units, through April 2014. LCRA is committed to buy a fixed amount of gas annually. LCRA's gas purchases under these contracts totaled \$126.8 million for FY 2008 and \$113.3 million for FY 2007, based on price indices. LCRA also pays approximately \$3.4 million per year for firm transportation rights on intrastate pipelines that deliver gas from other supply points.

Purchased Power: LCRA has 14 contracts with power marketers who provide firm electric energy ranging from 50 MW to 600 MW per month, for the period July 2008 through September 2009. The total minimum commitment from these contracts is more than \$3.2 million plus energy payments.

Wind Power: LCRA is committed to purchase 35 MW of wind power capacity from Texas' first commercial wind power plant, the Texas Wind Power Project. LCRA in turn sells 10 MW of this capacity to Austin Energy. During FY 2008, LCRA purchased 30 MW of wind power capacity from the Delaware Mountain Wind Farm. In FY 2008, LCRA also purchased 51 MW of wind power capacity from the Indian Mesa Wind Farm. Total wind power capacity is 116 MW, of which 106 MW is for LCRA and its customers. LCRA expects to pay approximately \$9.2 million in FY 2009 for purchases from all wind power plants, increasing to approximately \$11.5 million in FY 2016.

LOWER COLORADO RIVER AUTHORITY NOTES TO FINANCIAL STATEMENTS

Water Project Study: LCRA has entered into an agreement with the San Antonio Water System (SAWS) to study the feasibility of implementing the LCRA-SAWS Water Project. The project addresses long-term water needs in both the lower Colorado River basin and the San Antonio area. As proposed, the project would conserve and develop water in the region through the use of off-channel storage facilities, the conjunctive use of groundwater for agriculture, and agricultural conservation. The project would provide up to 150,000 acre-feet of water per year for the San Antonio region, provide a more reliable water supply for agricultural needs in the lower Colorado River basin, address rural water needs upstream of the LCRA Highland Lakes and increase lake levels in lakes Buchanan and Travis over those expected without the project. The study phase, estimated to be completed by March 2010 with a possible five-year extension at a total cost of approximately \$49.1 million, includes engineering feasibility and environmental studies and costs to obtain necessary permits for development and transfer of water. LCRA, in its role as project manager, receives advances from SAWS to fund this study. SAWS has the option to cancel the study with a 100 percent refund of unexpended funds and a 50 percent refund of expended funds due to SAWS when cancelled. As of June 30, 2008, LCRA has received \$34.8 million from SAWS, as well as grants of \$0.6 million from U. S. Fish and Wildlife Service and \$0.3 million from U. S. Department of Agriculture, for a total of \$35.7 million and has expended \$31.5 million in study costs.

Insurance Self-Funding: In addition to the purchase of commercial insurance, LCRA has established a self-insurance program to finance risk of loss. LCRA is exposed to various risks of loss related to torts; theft of, damage to and destruction of assets; errors and omissions; injuries to employees; and natural disasters. LCRA self-funds each worker's compensation claim up to \$400,000 and each general liability claim up to a maximum of \$2 million dependent on the insurance policy deductible. Self-funding of property damage varies from \$100,000 to \$2.5 million depending on the insurance deductible. Any claims or damages above self-funded amounts are covered by commercial general insurance. Settled claims have not exceeded commercial insurance coverage in any of the past three fiscal years. Based on an insurance risk analysis, LCRA carries no commercial insurance on transmission lines.

Accrued Liability: The accrued liability presented in the table below is associated with obligations resulting from environmental regulations established by federal, state and local authorities. Although the effect of future environmental regulations upon existing and proposed facilities and operations cannot be determined, LCRA monitors proposed changes and takes actions necessary to mitigate adverse impacts to its operations. At the present, no materially adverse impacts are anticipated.

Changes in the accrued liability amount for FY 2007 and 2008 were as follows:

	Balance Beginning of Year	Changes in Estimates	Payments	Balance End of Year
FY 2007	\$ 1,991,000	\$ 194,000	\$ 308,000	\$ 1,877,000
FY 2008	\$ 1,877,000	\$ 227,000	\$ 302,000	\$ 1,802,000

Litigation: There are various lawsuits in which LCRA is involved. LCRA's management, including its general counsel, estimates that the potential claims against LCRA not covered by insurance resulting from such litigation would not materially affect LCRA's financial position, results of operations and cash flows.

LOWER COLORADO RIVER AUTHORITY
NOTES TO FINANCIAL STATEMENTS

7. Capital Asset Activity

Capital asset activity for the year ended June 30, 2008 was as follows:

	Beginning Balance	Additions	Transfers from Construction in Progress	Retirements	Depreciation/ Depletion	Ending Balance
(Dollars in Thousands)						
Utility plant in service:						
Depreciable assets	\$ 3,483,918	\$	\$ 250,803	\$ (25,468)	\$	\$ 3,709,253
Non-depreciable assets	54,145		12,407	(5)		66,547
Total utility plant in service	3,538,063	-	263,210	(25,473)	-	3,775,800
Construction work in progress:						
Non-depreciable assets	200,272	373,727	(265,207)	(569)		308,223
Oil and gas property:						
Depletable assets	28,158					28,158
Other physical property:						
Depreciable assets	31,772		1,967	(401)		33,338
Non-depreciable assets	20,223		30			20,253
Total other physical property	51,995	-	1,997	(401)	-	53,591
Less accumulated depreciation	(1,232,826)		-	14,619	(120,195)	(1,338,402)
Capital assets, net	\$ 2,585,662	\$ 373,727	\$ -	\$ (11,824)	\$ (120,195)	\$ 2,827,370

Capital asset activity for the year ended June 30, 2007, was as follows:

	Beginning Balance	Additions	Transfer from Construction in Progress	Retirements	Depreciation/ Depletion	Ending Balance
(Dollars in Thousands)						
Utility plant in service:						
Depreciable assets	\$ 3,295,431	\$ 425	\$ 223,599	\$ (35,537)	\$	\$ 3,483,918
Non-depreciable assets	35,862		18,299	(16)		54,145
Total utility plant in service	3,331,293	425	241,898	(35,553)	-	3,538,063
Construction work in progress:						
Non-depreciable assets	209,008	240,926	(249,705)	43		200,272
Oil and gas property:						
Depletable assets	28,158					28,158
Other physical property:						
Depreciable assets	27,275	(129)	5,040	(414)		31,772
Non-depreciable assets	20,073		150			20,223
Total other physical property	47,348	(129)	5,190	(414)	-	51,995
Less accumulated depreciation	(1,150,936)		2,617	24,884	(109,391)	(1,232,826)
Capital assets, net	\$ 2,464,871	\$ 241,222	\$ -	\$ (11,040)	\$ (109,391)	\$ 2,585,662

**LOWER COLORADO RIVER AUTHORITY
NOTES TO FINANCIAL STATEMENTS**

8. Segment Reporting

Governments that use enterprise fund accounting and reporting standards to report their activities are required to present segment information. A segment is an identifiable activity reported as or within an enterprise fund or another stand-alone entity that has one or more bonds outstanding with a revenue stream pledged in support of that debt. In addition, the activity's revenues, expenses, gains and losses, assets, and liabilities are required to be accounted for separately. An external party should impose the requirements for separate accounting. LCRA TSC qualifies as a segment.

Segment information for LCRA TSC:

**LCRA TRANSMISSION SERVICES CORPORATION - SEGMENT INFORMATION
BALANCE SHEETS**

(Dollars in Thousands)

	June 30, 2008	June 30, 2007
<i>Assets</i>		
Current Assets	<u>78,755</u>	<u>77,647</u>
Long-Term Assets		
Restricted cash and cash equivalents	54	13,016
Restricted investments	72	123
Accounts receivable from LCRA - restricted	51,166	44,134
Capital assets:		
Utility plant in service	1,457,870	1,349,536
Construction work in progress	36,997	53,943
Less accumulated depreciation	(277,435)	(241,890)
Capital assets, net	1,217,432	1,161,589
Deferred charges:		
Costs to be recovered from revenues	68,234	42,837
Issue costs	21,037	17,294
Deferred charges, net	89,271	60,131
Total long-term assets	1,357,995	1,278,993
Total Assets	<u>\$ 1,436,750</u>	<u>\$ 1,356,640</u>
<i>Liabilities</i>		
Current Liabilities	<u>69,712</u>	<u>106,471</u>
Long-Term Liabilities		
Accounts payable to LCRA from Construction Fund	12,878	8,934
Accounts payable from restricted assets	7,270	11,625
Bonds, notes and loans payable	1,162,842	1,072,296
Deferred credits	397	1
Total long-term liabilities	1,183,387	1,092,856
Total liabilities	1,253,099	1,199,327
<i>Equity</i>		
Invested in capital assets, net of related debt	126,502	104,632
Unrestricted	57,149	52,681
Total equity	183,651	157,313
Total Liabilities and Equity	<u>\$ 1,436,750</u>	<u>\$ 1,356,640</u>

LOWER COLORADO RIVER AUTHORITY
NOTES TO FINANCIAL STATEMENTS

LCRA TRANSMISSION SERVICES CORPORATION - SEGMENT INFORMATION
STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN EQUITY

(Dollars in Thousands)

	Year Ended June 30,	
	2008	2007
Operating Revenues		
Transmission	\$ 180,164	\$ 169,013
Transformation	9,753	9,178
Other	822	635
Total operating revenues	<u>190,739</u>	<u>178,826</u>
Operating Expenses		
Operations	66,631	61,269
Maintenance	9,372	9,669
Depreciation and amortization	38,661	35,067
Total operating expenses	<u>114,664</u>	<u>106,005</u>
Operating income	76,075	72,821
Nonoperating Revenues (Expenses)		
Interest and other income	4,539	10,215
Interest and other expenses	<u>(81,531)</u>	<u>(68,453)</u>
Total nonoperating revenues (expenses)	<u>(76,992)</u>	<u>(58,238)</u>
Income before costs to be recovered from revenues, capital contributions, transfers in, and special item	(917)	14,583
Costs To Be Recovered from Revenues	25,397	1,269
Capital Contributions	<u>1,132</u>	<u>1,859</u>
Income before transfers in and special item	25,612	17,711
Transfers In	726	842
Special Item - Loss on Early Defeasance of Debt	<u>-</u>	<u>(1,356)</u>
Change in Equity	26,338	17,197
Total Equity, Beginning of Year	<u>157,313</u>	<u>140,116</u>
Total Equity, End of Year	<u>\$ 183,651</u>	<u>\$ 157,313</u>

**LOWER COLORADO RIVER AUTHORITY
NOTES TO FINANCIAL STATEMENTS**

**LCRA TRANSMISSION SERVICES CORPORATION - SEGMENT INFORMATION
STATEMENTS OF CASH FLOWS**

(Dollars in Thousands)

	Year Ended June 30,	
	2008	2007
Cash Flows From Operating Activities		
Receipts from customers	\$ 186,281	\$ 176,484
Payments to suppliers	(76,236)	(71,371)
Net cash provided by operating activities	<u>110,045</u>	<u>105,113</u>
Cash Flows From Noncapital Financing Activities		
Other expenses	(5,482)	(6,974)
Net cash used in noncapital financing activities	<u>(5,482)</u>	<u>(6,974)</u>
Cash Flows From Capital and Related Financing Activities		
Purchases of property, plant and equipment	(99,966)	(181,059)
Debt issue costs	(5,489)	(1,867)
Proceeds from long-term debt issues	173,402	137,958
Proceeds from commercial paper issues	110,100	165,000
Principal payments on long-term debt	(36,090)	(37,308)
Payments to defease and refund debt and related issue costs	(215,000)	(149,122)
Interest paid	(43,111)	(32,854)
Cash received on sale of assets	4	16
Capital contributions	1,132	1,859
Accounts payable to LCRA	(12,751)	2,105
Net cash used in capital and related financing activities	<u>(127,769)</u>	<u>(95,272)</u>
Cash Flows From Investing Activities		
Sale and maturity of investment securities	79,994	68,947
Purchase of investment securities	(72,808)	(71,312)
Interest received	3,964	8,258
Net cash provided in investing activities	<u>11,150</u>	<u>5,893</u>
Net Increase (Decrease) in Cash and Cash Equivalents	(12,056)	8,760
Cash and Cash Equivalents, Beginning of Period	29,978	21,218
Cash and Cash Equivalents, End of Period	<u>\$ 17,922</u>	<u>\$ 29,978</u>

**LOWER COLORADO RIVER AUTHORITY
NOTES TO FINANCIAL STATEMENTS**

**LCRA TRANSMISSION SERVICES CORPORATION - SEGMENT INFORMATION
STATEMENTS OF CASH FLOWS**

(Dollars in Thousands)

	Year Ended June 30,	
	2008	2007
Reconciliation of Operating Income to Net Cash Flows provided by		
Operating Activities		
Operating income	\$ 76,075	\$ 72,821
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation and amortization	38,661	35,067
Changes in assets and liabilities:		
Accounts receivable - trade	(6,991)	(2,344)
Inventories	112	40
Current liabilities	2,188	(471)
Net cash provided by operating activities	<u>\$ 110,045</u>	<u>\$ 105,113</u>
Noncash Investing Activities		
Investment market adjustments	<u>\$ 504</u>	<u>\$ 671</u>
Noncash Financing for Property, Plant and Equipment Expenditures		
Purchase of equipment through short-term trade payables	<u>\$ 41</u>	<u>\$ 56,206</u>

LOWER COLORADO RIVER AUTHORITY
Unaudited Consolidating Schedule of Balance Sheet Information
(Dollars in Thousands)

June 30, 2008

	LCRA Transmission Services Corporation		Eliminations	LCRA and Obligated Affiliates	GenTex Power Corporation	Eliminations	LCRA, Reporting Entity
	LCRA	Corporation			Corporation		Entity
Assets							
Current Assets:							
Cash and cash equivalents	\$ 81,698	\$ 17,868	\$	\$ 99,566	\$ 13,643	\$	\$ 113,209
Investments	14,743	24,960		39,703			39,703
Receivables, net	141,519	31,963		173,482			173,482
Receivables, GenTex	704			704		(704)	-
Receivables, LCRA Transmission Services	20,789		(20,789)	-			-
Contractual note receivable, LCRA Transmission Services - current	18,222		(18,222)	-			-
Accrued interest receivable	382	95		477			477
Inventories	126,494	3,869		130,363	1,685		132,048
Other	20,690			20,690	37	(6,060)	14,667
Total current assets	425,241	78,755	(39,011)	464,985	15,365	(6,764)	473,586
Long-term Assets:							
Restricted cash and cash equivalents	23,081	54		23,135			23,135
Restricted investments	66,253	72		66,325			66,325
Unrestricted investments	53,947			53,947			53,947
Accounts receivable from LCRA - restricted		51,166	(51,166)	-			-
Capital assets:							
Utility plant in service	2,165,738	1,457,870		3,623,608	152,192		3,775,800
Construction work in progress	271,169	36,997		308,166	57		308,223
Oil and gas property	28,158			28,158			28,158
Other physical property	53,591			53,591			53,591
Less accumulated depreciation	(1,033,663)	(277,435)		(1,311,098)	(27,304)		(1,338,402)
Capital assets, net	1,484,993	1,217,432	-	2,702,425	124,945	-	2,827,370
Water rights, net	87,397			87,397			87,397
Contractual note receivable, LCRA Transmission Services	235,209		(235,209)	-			-
Other	11,107			11,107			11,107
Deferred charges, net	364,757	89,271		454,028		(117,578)	336,450
Total long-term assets	2,326,744	1,357,995	(286,375)	3,398,364	124,945	(117,578)	3,405,731
Total Assets	\$ 2,751,985	\$ 1,436,750	\$ (325,386)	\$ 3,863,349	\$ 140,310	\$ (124,342)	\$ 3,879,317
Liabilities							
Current Liabilities:							
Accounts payable	\$ 193,337	\$ 13,300	\$	\$ 206,637	\$ 5,821	\$	\$ 212,458
Accounts payable to LCRA		7,910	(7,910)	-	704	(704)	-
Accounts payable, GenTex				-			-
Compensated absences	11,030			11,030			11,030
Contractual note payable to LCRA - current		18,222	(18,222)	-			-
Bonds, notes, and loans payable	228,668	30,280		258,948			258,948
Total current liabilities	433,035	69,712	(26,132)	476,615	6,525	(704)	482,436
Long-term Liabilities:							
Accounts payable from restricted assets	35,763	7,270		43,033			43,033
Accounts payable to LCRA from Construction Fund		12,878	(12,878)	-			-
Accounts payable to LCRA Transmission Services	51,167		(51,167)	-			-
Contractual note payable to LCRA		235,209	(235,209)	-			-
Bonds, notes, and loans payable	1,430,651	927,633		2,358,284			2,358,284
Deferred credits	176,400	397		176,797	123,638	(123,638)	176,797
Total long-term liabilities	1,693,981	1,183,387	(299,254)	2,578,114	123,638	(123,638)	2,578,114
Total liabilities	2,127,016	1,253,099	(325,386)	3,054,729	130,163	(124,342)	3,060,550
Equity							
Invested in capital assets, net of related debt	489,489	126,502	12,878	628,869	1,307	6,060	636,236
Restricted other	31,873			31,873			31,873
Unrestricted	103,607	57,149	(12,878)	147,878	8,840	(6,060)	150,658
Total equity	624,969	183,651	-	808,620	10,147	-	818,767
Total Liabilities and Equity	\$ 2,751,985	\$ 1,436,750	\$ (325,386)	\$ 3,863,349	\$ 140,310	\$ (124,342)	\$ 3,879,317

SUPPLEMENTAL CONSOLIDATING SCHEDULES

LOWER COLORADO RIVER AUTHORITY
Unaudited Consolidating Schedule of Balance Sheet Information

(Dollars in Thousands)

June 30, 2007

	LCRA Transmission Services Corporation		Eliminations	LCRA and Obligated Affiliate	GenTex Power Corporation	Eliminations	LCRA Reporting Entity
	LCRA	Corporation					
Assets							
Current Assets:							
Cash and cash equivalents	\$ 87,217	\$ 16,962	\$ -	\$ 104,179	\$ 12,673	\$ -	\$ 116,852
Investments	16,478	31,591	-	48,069	-	-	48,069
Receivables, net	102,787	24,972	-	127,759	280	-	128,039
Receivables, GenTex	217	-	-	217	-	(217)	-
Receivables, LCRA Transmission Services	23,290	-	(23,290)	-	-	-	-
Contractual note receivable, LCRA Transmission Services - current	19,155	-	(19,155)	-	-	-	-
Accrued interest receivable	549	141	-	690	-	-	690
Inventories	95,787	3,981	-	99,768	1,606	-	101,374
Other	8,056	-	-	8,056	48	(6,060)	2,044
Total current assets	<u>353,536</u>	<u>77,647</u>	<u>(42,445)</u>	<u>388,738</u>	<u>14,607</u>	<u>(6,277)</u>	<u>397,068</u>
Long-term Assets:							
Restricted cash and cash equivalents	11,850	13,016	-	24,866	-	-	24,866
Restricted investments	58,376	123	-	58,499	-	-	58,499
Unrestricted investments	87,058	-	-	87,058	-	-	87,058
Accounts receivable from LCRA - restricted	-	44,134	(44,134)	-	-	-	-
Capital assets:							
Utility plant in service	2,037,578	1,349,536	-	3,387,114	150,949	-	3,538,063
Construction work in progress	145,085	53,943	-	199,028	1,244	-	200,272
Oil and gas property	28,158	-	-	28,158	-	-	28,158
Other physical property	51,995	-	-	51,995	-	-	51,995
Less accumulated depreciation	(969,739)	(241,890)	-	(1,211,629)	(21,197)	-	(1,232,826)
Capital assets, net	<u>1,293,077</u>	<u>1,161,589</u>	<u>-</u>	<u>2,454,666</u>	<u>130,996</u>	<u>-</u>	<u>2,585,662</u>
Water rights, net	87,397	-	-	87,397	-	-	87,397
Contractual note receivable, LCRA Transmission Services	248,709	-	(248,709)	-	-	-	-
Other	11,348	-	-	11,348	-	-	11,348
Deferred charges, net	356,403	60,131	-	416,534	-	(123,610)	292,924
Total long-term assets	<u>2,154,218</u>	<u>1,278,993</u>	<u>(292,843)</u>	<u>3,140,368</u>	<u>130,996</u>	<u>(123,610)</u>	<u>3,147,754</u>
Total Assets	\$ 2,507,754	\$ 1,356,640	\$ (335,288)	\$ 3,529,106	\$ 145,603	\$ (129,887)	\$ 3,544,822
Liabilities							
Current Liabilities:							
Accounts payable	\$ 179,319	\$ 10,978	\$ -	\$ 190,297	\$ 2,166	\$ -	\$ 192,463
Accounts payable to LCRA	-	14,356	(14,356)	-	217	(217)	-
Compensated absences	9,872	-	-	9,872	-	-	9,872
Contractual note payable to LCRA - current	-	19,155	(19,155)	-	-	-	-
Bonds, notes, and loans payable	224,480	61,982	-	286,462	-	-	286,462
Total current liabilities	<u>413,671</u>	<u>106,471</u>	<u>(33,511)</u>	<u>486,631</u>	<u>2,383</u>	<u>(217)</u>	<u>488,797</u>
Long-term Liabilities:							
Accounts payable from restricted assets	5,967	11,625	-	17,592	-	-	17,592
Accounts payable to LCRA from Construction Fund	-	8,934	(8,934)	-	-	-	-
Accounts payable to LCRA Transmission Services	44,134	-	(44,134)	-	-	-	-
Contractual note payable to LCRA	-	248,709	(248,709)	-	-	-	-
Bonds, notes, and loans payable	1,299,640	823,587	-	2,123,227	-	-	2,123,227
Deferred credits	147,313	1	-	147,314	129,670	(129,670)	147,314
Total long-term liabilities	<u>1,497,054</u>	<u>1,092,856</u>	<u>(301,777)</u>	<u>2,288,133</u>	<u>129,670</u>	<u>(129,670)</u>	<u>2,288,133</u>
Total liabilities	<u>1,910,725</u>	<u>1,199,327</u>	<u>(335,288)</u>	<u>2,774,764</u>	<u>132,053</u>	<u>(129,887)</u>	<u>2,776,930</u>
Equity							
Invested in capital assets, net of related debt	463,990	104,632	8,934	577,556	1,326	6,060	584,942
Restricted other	24,622	-	-	24,622	-	-	24,622
Unrestricted	108,417	52,681	(8,934)	152,164	12,224	(6,060)	158,328
Total equity	<u>597,029</u>	<u>157,313</u>	<u>-</u>	<u>754,342</u>	<u>13,550</u>	<u>-</u>	<u>767,892</u>
Total Liabilities and Equity	\$ 2,507,754	\$ 1,356,640	\$ (335,288)	\$ 3,529,106	\$ 145,603	\$ (129,887)	\$ 3,544,822

LOWER COLORADO RIVER AUTHORITY

Unaudited Consolidating Schedule of Revenues, Expenses and Changes in Equity Information

(Dollars in Thousands)

Year Ended June 30, 2008

	LCRA	LCRA Transmission Services Corporation	Eliminations	LCRA and Obligated Affiliate	GenTex Power Corporation	Eliminations	LCRA Reporting Entity
Operating Revenues							
Electric	\$ 877,153	\$ 189,917	\$	\$ 1,067,070	\$ 207,114	\$ (210,109)	\$ 1,064,075
Water, wastewater and irrigation	62,766			62,766		(278)	62,488
Other	60,439	822		61,261	132	(131)	61,262
Total operating revenues	<u>1,000,358</u>	<u>190,739</u>	<u>-</u>	<u>1,191,097</u>	<u>207,246</u>	<u>(210,518)</u>	<u>1,187,825</u>
Operating Expenses							
Fuel	285,760			285,760	184,424		470,184
Purchased power	388,182			388,182		(210,109)	178,073
Operations	147,311	66,631		213,942	7,944	(409)	221,477
Maintenance	24,812	9,372		34,184	9,941		44,125
Depreciation, depletion and amortization	77,459	38,661		116,120	6,108		122,228
Total operating expenses	<u>923,524</u>	<u>114,664</u>	<u>-</u>	<u>1,038,188</u>	<u>208,417</u>	<u>(210,518)</u>	<u>1,036,087</u>
Operating income	76,834	76,075	-	152,909	(1,171)	-	151,738
Non-Operating Revenues(Expenses)							
Interest and other income	35,009	4,539	(16,013)	23,535	537		24,072
Interest and other expenses	(90,026)	(81,531)	16,013	(155,544)	(2,769)		(158,313)
Non-operating revenues(expenses)	<u>(55,017)</u>	<u>(76,992)</u>	<u>-</u>	<u>(132,009)</u>	<u>(2,232)</u>	<u>-</u>	<u>(134,241)</u>
Income (loss) before cost to be recovered from revenues, capital contributions and transfers in/(out)	21,817	(917)	-	20,900	(3,403)	-	17,497
Costs To Be Recovered from Revenues	2,364	25,397		27,761			27,761
Capital Contributions	4,485	1,132		5,617			5,617
Transfers In/(Out)	<u>(726)</u>	<u>726</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Change in Equity	27,940	26,338	-	54,278	(3,403)	-	50,875
Total Equity at Beginning of Year	<u>597,029</u>	<u>157,313</u>	<u>-</u>	<u>754,342</u>	<u>13,550</u>	<u>-</u>	<u>767,892</u>
Total Equity at End of Year	<u>\$ 624,969</u>	<u>\$ 183,651</u>	<u>\$ -</u>	<u>\$ 808,620</u>	<u>\$ 10,147</u>	<u>\$ -</u>	<u>\$ 818,767</u>

LOWER COLORADO RIVER AUTHORITY

Unaudited Consolidating Schedule of Revenues, Expenses and Changes in Equity Information

(Dollars in Thousands)

	Year Ended June 30, 2007						
	LCRA	LCRA Transmission Services Corporation	Eliminations	LCRA and Obligated Affiliate	GenTex Power Corporation	Eliminations	LCRA Reporting Entity
Operating Revenues							
Electric	\$ 814,556	\$ 178,191	\$ -	\$ 992,747	\$ 193,843	\$ (195,257)	\$ 991,333
Water, wastewater and irrigation	56,056			56,056		(193)	55,863
Other	44,054	635		44,689	180	(179)	44,690
Total operating revenues	<u>914,666</u>	<u>178,826</u>	<u>-</u>	<u>1,093,492</u>	<u>194,023</u>	<u>(195,629)</u>	<u>1,091,886</u>
Operating Expenses							
Fuel	234,727			234,727	165,063		399,790
Purchased power	372,638			372,638		(195,257)	177,381
Operations	140,073	61,269		201,342	7,874	(372)	208,844
Maintenance	29,924	9,669		39,593	4,869		44,462
Depreciation, depletion and amortization	71,434	35,067		106,501	6,054		112,555
Total operating expenses	<u>848,796</u>	<u>106,005</u>	<u>-</u>	<u>954,801</u>	<u>183,860</u>	<u>(195,629)</u>	<u>943,032</u>
Operating income	65,870	72,821	-	138,691	10,163	-	148,854
Non-Operating Revenues(Expenses)							
Interest and other income	38,659	10,215	(16,891)	31,983	526		32,509
Interest and other expenses	(87,895)	(68,453)	16,891	(139,457)	(3,293)		(142,750)
Non-operating revenues(expenses)	<u>(49,236)</u>	<u>(58,238)</u>	<u>-</u>	<u>(107,474)</u>	<u>(2,767)</u>	<u>-</u>	<u>(110,241)</u>
Income before (prior costs) costs to be recovered from revenues, capital contributions, transfers in/(out) and special item	16,634	14,583	-	31,217	7,396	-	38,613
(Prior Costs) Costs To Be Recovered from Revenues	(6,403)	1,269		(5,134)			(5,134)
Capital Contributions	9,618	1,859		11,477			11,477
Transfers In/(Out)	(842)	842		-			-
Special Item - Loss on Early Defeasance of Debt	<u>(37)</u>	<u>(1,356)</u>	<u>-</u>	<u>(1,393)</u>	<u>-</u>	<u>-</u>	<u>(1,393)</u>
Change in Equity	18,970	17,197	-	36,167	7,396	-	43,563
Total Equity at Beginning of Year	<u>578,059</u>	<u>140,116</u>	<u>-</u>	<u>718,175</u>	<u>6,154</u>	<u>-</u>	<u>724,329</u>
Total Equity at End of Year	<u>\$ 597,029</u>	<u>\$ 157,313</u>	<u>\$ -</u>	<u>\$ 754,342</u>	<u>\$ 13,550</u>	<u>\$ -</u>	<u>\$ 767,892</u>

LOWER COLORADO RIVER AUTHORITY
Unaudited Consolidating Schedule of Cash Flow Information

(Dollars in Thousands)

	Year Ended June 30, 2008						
	LCRA	LCRA Transmission Services Corporation	Eliminations	LCRA and Obligated Affiliates	GenTex Power Corporation	Eliminations	LCRA Reporting Entity
Cash Flows from Operating Activities							
Received from customers	\$ 979,515	\$ 186,281	\$ -	\$ 1,165,796	\$ 201,495	\$ (204,485)	\$ 1,162,806
Payments for goods and services	(736,225)	(76,236)	26,993	(785,468)	(198,724)	208,827	(775,365)
Payments to employees	(131,470)	-	(26,993)	(158,463)	-	(4,342)	(162,805)
Other revenues (expenses)	(6,137)	-	-	(6,137)	487	-	(5,650)
Net cash provided by operating activities	105,683	110,045	-	215,728	3,258	-	218,986
Cash Flows from Noncapital Financing Activities							
Grant proceeds received	8,210	-	-	8,210	-	-	8,210
Other revenues (expenses)	6,637	(5,482)	-	1,155	(2,768)	-	(1,613)
Net cash provided by (used in) noncapital financing activities	14,847	(5,482)	-	9,365	(2,768)	-	6,597
Cash Flows from Capital and Related Financing Activities							
Accounts receivable / payable related to bond proceeds	12,751	(12,751)	-	-	-	-	-
Proceeds from contractual commitment	30,445	-	(30,445)	-	-	-	-
Purchases for property, plant and equipment	(253,020)	(99,966)	-	(352,986)	(57)	-	(353,043)
Expenditures for prepaid power	0	-	-	-	-	-	-
Proceeds from sale of capital assets	6,692	4	-	6,696	-	-	6,696
Contributed capital received for capital expenditures	4,805	1,132	-	5,937	-	-	5,937
Proceeds from bond issues and commercial paper	415,660	283,502	-	699,162	-	-	699,162
Debt principal payments and commercial paper redemptions	(80,776)	(36,090)	30,445	(86,421)	-	-	(86,421)
Interest paid	(98,633)	(43,111)	16,013	(125,731)	-	-	(125,731)
Debt issue costs	(1,530)	(5,489)	-	(7,019)	-	-	(7,019)
Payments to refund debt and defease debt costs	(206,990)	(215,000)	-	(421,990)	-	-	(421,990)
Net cash provided by (used in) capital and related financing activities	(170,596)	(127,769)	16,013	(282,352)	(57)	-	(282,409)
Cash Flows from Investing Activities							
Sale and maturity of investment securities	226,009	79,994	-	306,003	-	-	306,003
Purchase of investment securities	(195,404)	(72,808)	-	(268,212)	-	-	(268,212)
Interest received	25,031	3,964	(16,013)	12,982	537	-	13,519
Infrastructure financial assistance activity	142	-	-	142	-	-	142
Net cash provided by (used in) investing activities	55,778	11,150	(16,013)	50,915	537	-	51,452
Net Increase (Decrease) in Cash and Cash Equivalents	5,712	(12,056)	-	(6,344)	970	-	(5,374)
Cash and Cash Equivalents, Beginning of Year	99,067	29,978	-	129,045	12,673	-	141,718
Cash and Cash Equivalents, End of Year	\$ 104,779	\$ 17,922	\$ -	\$ 122,701	\$ 13,643	\$ -	\$ 136,344
Reconciliation of Operating Income to Net Cash Provided by Operating Activities							
Operating income	\$ 76,834	\$ 76,075	\$ -	\$ 152,909	\$ (1,171)	\$ -	\$ 151,738
Adjustments to reconcile operating income to net cash provided by operating activities:							
Depreciation, depletion and amortization	77,459	38,661	-	116,120	6,108	-	122,228
Changes in assets and liabilities:							
Accounts receivable	(29,236)	(6,991)	(9,901)	(46,128)	281	487	(45,360)
Inventories	(30,741)	112	-	(30,629)	(45)	-	(30,674)
Other current assets	(12,600)	-	-	(12,600)	(23)	-	(12,623)
Current liabilities	6,725	2,188	9,901	18,814	4,140	(487)	22,467
Other deferred charges	(327)	-	-	(327)	-	(6,032)	(6,359)
Deferred credits and other long-term liabilities	17,569	-	-	17,569	(6,032)	6,032	17,569
Net cash provided by operating activities	\$ 105,683	\$ 110,045	\$ -	\$ 215,728	\$ 3,258	\$ -	\$ 218,986
Noncash Investing Activities							
Investment market adjustments	\$ 3,636	\$ 504	\$ -	\$ 4,140	\$ -	\$ -	\$ 4,140
Noncash Financing for Property, Plant and Equipment Expenditures							
Purchase of equipment through short-term trade payable	\$ 24,369	\$ 41	\$ -	\$ 24,410	\$ -	\$ -	\$ 24,410

LOWER COLORADO RIVER AUTHORITY
Unaudited Consolidating Schedule of Cash Flow Information
(Dollars in Thousands)

	Year Ended June 30, 2007						
	LCRA	LCRA Transmission Services Corporation	Eliminations	LCRA and Obligated Affiliates	GenTex Power Corporation	Eliminations	LCRA Reporting Entity
Cash Flows from Operating Activities							
Received from customers	\$ 906,867	\$ 176,484	\$ (5,643)	\$ 1,077,708	\$ 189,394	\$ (189,585)	\$ 1,077,517
Payments for goods and services	(625,564)	(71,371)	32,616	(664,319)	(178,755)	193,743	(649,331)
Payments to employees	(129,063)		(26,973)	(156,036)		(4,158)	(160,194)
Other expenses	(1,675)			(1,675)	(908)		(2,583)
Net cash provided by operating activities	<u>150,565</u>	<u>105,113</u>	<u>-</u>	<u>255,678</u>	<u>9,731</u>	<u>-</u>	<u>265,409</u>
Cash Flows from Noncapital Financing Activities							
Grant proceeds received	9,605			9,605			9,605
Other revenues (expenses)	2,192	(6,974)		(4,782)	(3,294)		(8,076)
Net cash provided by (used in) noncapital financing activities	<u>11,797</u>	<u>(6,974)</u>	<u>-</u>	<u>4,823</u>	<u>(3,294)</u>	<u>-</u>	<u>1,529</u>
Cash Flows From Capital and Related Financing Activities							
Accounts receivable / payable related to bond proceeds	(2,105)	2,105		-			-
Proceeds from contractual commitment	31,568		(31,568)	-			-
Purchases for property, plant and equipment	(103,581)	(181,059)		(284,640)	(1,001)		(285,641)
Proceeds from sale of capital assets	225	16		241			241
Contributed capital received for capital expenditures	8,520	1,859		10,379			10,379
Proceeds from bond issues and commercial paper	102,400	302,958		405,358			405,358
Debt principal payments and commercial paper redemptions	(83,605)	(37,308)	31,568	(89,345)			(89,345)
Interest paid	(96,240)	(32,854)	16,891	(112,203)			(112,203)
Debt issue costs	(26)	(1,867)		(1,893)			(1,893)
Payments to refund debt and defease debt costs	(5,259)	(149,122)		(154,381)			(154,381)
Net cash provided by (used in) capital and related financing activities	<u>(148,103)</u>	<u>(95,272)</u>	<u>16,891</u>	<u>(226,484)</u>	<u>(1,001)</u>	<u>-</u>	<u>(227,485)</u>
Cash Flows from Investing Activities							
Sale and maturity of investment securities	207,702	68,947		276,649			276,649
Purchase of investment securities	(225,234)	(71,312)		(296,546)			(296,546)
Interest received	31,965	8,258	(16,891)	23,332	526		23,858
Infrastructure financial assistance activity	485			485			485
Net cash provided by (used in) investing activities	<u>14,918</u>	<u>5,893</u>	<u>(16,891)</u>	<u>3,920</u>	<u>526</u>	<u>-</u>	<u>4,446</u>
Net Increase in Cash and Cash Equivalents	29,177	8,760	-	37,937	5,962	-	43,899
Cash and Cash Equivalents, Beginning of Year	69,890	21,218		91,108	6,711		97,819
Cash and Cash Equivalents, End of Year	\$ 99,067	\$ 29,978	\$ -	\$ 129,045	\$ 12,673	\$ -	\$ 141,718
Reconciliation of Operating Income to Net Cash Provided by Operating Activities:							
Operating income	\$ 65,870	\$ 72,821	\$ -	\$ 138,691	\$ 10,163	\$ -	\$ 148,854
Adjustments to reconcile operating income to net cash provided by operating activities:							
Depreciation, depletion and amortization	71,434	35,067		106,501	6,054		112,555
Changes in assets and liabilities:							
Accounts receivable	19,547	(2,344)	(5,675)	11,528	1,413	(908)	12,033
Inventories	(3,605)	40		(3,565)	(183)		(3,748)
Other current assets	(1,186)			(1,186)			(1,186)
Current liabilities	15,695		5,675	21,370	(1,674)	908	20,604
Other deferred charges	(1,940)			(1,940)		(6,043)	(7,983)
Deferred credits and other long-term liabilities	(15,250)	(471)		(15,721)	(6,042)	6,043	(15,720)
Net cash provided by operating activities	<u>\$ 150,565</u>	<u>\$ 105,113</u>	<u>\$ -</u>	<u>\$ 255,678</u>	<u>\$ 9,731</u>	<u>\$ -</u>	<u>\$ 265,409</u>
Noncash Investing Activities							
Investment market adjustments	\$ 4,239	\$ 671	\$ -	\$ 4,910	\$ -	\$ -	\$ 4,910
Noncash Financing for Property, Plant and Equipment Expenditures							
Purchase of equipment through short-term trade payable	\$ (56,206)	\$ 56,206	\$ -	\$ -	\$ -	\$ -	\$ -
Asset retirement obligation	\$ (9,270)	\$ -	\$ -	\$ (9,270)	\$ -	\$ -	\$ (9,270)
Acquisition of Alleyton water/wastewater facility	\$ 2,446	\$ -	\$ -	\$ 2,446	\$ -	\$ -	\$ 2,446

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APPENDIX C

LCRA TRANSMISSION SERVICES CORPORATION

This APPENDIX C describes the LCRA Transmission Services Corporation (referred to in this appendix as the "Corporation"). Other capitalized terms used in this APPENDIX C and not otherwise defined in this Official Statement shall have the meanings ascribed to them in section "APPENDIX C DEFINITIONS" of this appendix found on page C-27 hereof.

A more detailed description of the State's electric transmission regulatory scheme and its participants can be found in section "DESCRIPTION OF THE TRANSMISSION REGULATORY SCHEME WITHIN ERCOT" of this appendix found on page C-15 hereof.

The Corporation has no direct liability with respect to payment of the principal of, premium, if any, or interest on Parity Debt, including the Bonds. The Corporation's obligations are limited solely to payments made to LCRA under the Initial Contractual Commitment. The Corporation's payments under the Initial Contractual Commitment constitute a portion of LCRA's Pledged Revenues which have been pledged to the payment of the outstanding Parity Debt, including the Bonds.

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THE CORPORATION

General

The Corporation is a nonprofit corporation created by LCRA to act on LCRA's behalf pursuant to Chapter 152, Texas Water Code, as amended, to conduct LCRA's electric transmission business, including providing electric transmission services outside of LCRA's traditional electric service territory. The Corporation owns and operates all of the Transferred Transmission Assets previously owned by LCRA and transferred to the Corporation pursuant to the Initial Contractual Commitment as well as transmission and transformation assets constructed and financed by the Corporation with Transmission Contract Debt. See "- Initial Contractual Commitment" below. LCRA personnel, including primarily those that operate LCRA's Transmission Services Business Unit, are responsible for performing all of the Corporation's activities pursuant to the Services Agreement. See "- Business Operations" below.

The Corporation is a TSP under the State's open-access electric transmission regulatory scheme within the approximately 75% geographic area of the State covered by ERCOT. See "DESCRIPTION OF THE TRANSMISSION REGULATORY SCHEME WITHIN ERCOT" below. In such capacity, the Corporation is entitled to receive compensation from all DSPs using the electric transmission system within ERCOT. As a TSP in the ERCOT region of the State, the rates that the Corporation charges for transmission services are regulated by the PUC and determined pursuant to TCOS rate proceedings filed with, and approved by, the PUC. See "- Description of Revenues" and "-TCOS Rate Proceedings" below.

The Corporation has legal title to its electric transmission and transformation assets. In addition, LCRA has also assigned to the Corporation certain leases of transmission assets owned by LCRA's wholesale electric generation customers and formerly leased by such customers to LCRA. Other than (i) the ownership of assets, (ii) the possession of the CCNs issued by the PUC and (iii) the TCOS filing tariffs, each of which is required for

the Corporation to be deemed a TSP under PUC rules, all required functions and activities of the Corporation are performed by LCRA and its staff, on behalf of the Corporation, under the Services Agreement.

As noted above, the Corporation owns transmission projects outside of LCRA's traditional electric service area as well as within such service area. The Corporation is pursuing transmission projects throughout ERCOT. See "- Corporation Facilities, Assets and Planned Acquisitions/Expansions" below.

Electric transmission is critical to the success of retail electric competition if electric power is to be provided effectively by various REPs to retail consumers in areas of the ERCOT system open to retail competition. However, transmission systems in some areas of the State, including those within ERCOT, do not have the capacity to deliver the amount of electricity required to fully support the competitive market. These inadequate facilities can affect system reliability, impact market costs and limit market transactions. ERCOT has identified major transmission constraints and is working with various utilities (or the electric transmission affiliates of such utilities) to correct these constraints. Projects to alleviate transmission constraints within the electric service areas formerly served by two IOU-affiliated TSPs have been a focus of prior agreements entered into by the Corporation with these companies. See "- Corporation Facilities, Assets and Planned Acquisitions/Expansions" and "DESCRIPTION OF THE TRANSMISSION REGULATORY SCHEME WITHIN ERCOT - Transmission Constraints" below.

The Corporation Board is appointed by and serves at the will of the LCRA Board. Pursuant to the LCRA Master Resolution and other provisions of State law, the LCRA Board must exercise control over all operations of the Corporation. The current membership of the Corporation Board, as required by the Bylaws of the Corporation, is made up entirely by the membership of the LCRA Board. Specifically, the LCRA Board must approve any debt incurred by the Corporation and may not approve the issuance or incurrence of any debt if, in the judgement of the LCRA Board, the satisfaction of the obligations relating to such debt will materially adversely affect the ability of the Corporation to comply with the provisions of any Contractual Commitments, including the Initial Contractual Commitment, or the Corporation's other obligations. Further, and to the extent permitted by law, the LCRA Board has retained the right (i) to approve the budget of the Corporation, (ii) to appoint and remove the members of the Corporation Board, (iii) to approve the articles of incorporation and by-laws, and any amendments thereto, (iv) to approve the disposition of all or substantially all of the assets of the Corporation and (v) to require that the Corporation's Fiscal Year be the same as LCRA's fiscal year.

From time to time the Corporation may enter into policy agreements with the PUC in order to facilitate the PUC's approval of CCN transfers or acquisitions for particular transmission projects as well as TCOS rate cases when such approval is required. The Corporation has entered into such an agreement with the PUC in connection with the PUC's approval of a proceeding relating to the transfer of a CCN. Pursuant to the agreement, the Corporation has agreed to structure any transfer of unrestricted funds from the Corporation to LCRA, other than Extraordinary LCRA Optional Purchase Price Payments under the Initial Contractual Commitment, as a loan which must be repaid within three years. Under the agreement, such a loan may not be forgiven by the Corporation without approval by the PUC. Such policy agreements are between the Corporation and the PUC and are subject to change at anytime as agreed to by such parties and are not for the benefit of the owners of Transmission Contract Debt.

Description of Revenues

Transmission Rates and Revenues. Transmission rates within the ERCOT system are determined pursuant to a universal 100% "postage stamp" rate which spreads the total annual costs of transmission services among DSPs according to their electric loads. The transmission costs are determined pursuant to TCOS rate cases required to be filed by all TSPs, including the Corporation, from time to time. Every electric end-use consumer in the ERCOT system pays a portion of the total cost of maintaining a reliable transmission system within ERCOT. Transmission charges are calculated by multiplying a DSP's share of the electric load within ERCOT by the ERCOT "postage stamp" rate. The load shares and rates are determined by the PUC through its TCOS regulatory process.

The PUC determines each DSP's share of the total electric load within ERCOT based on the DSP's 4-Month Peak. Each year, ERCOT compiles and reports 4-Month Peak data for all DSPs within ERCOT to the PUC for review and approval. This method allows the PUC to accurately calculate each DSP's share of the total electric load within ERCOT. In 2007, the total 4-Month Peak for all DSPs within ERCOT was 57,650,015 kilowatts. Each

DSP makes a monthly payment to each TSP within ERCOT equal to 1/12 of the DSP's current 4-Month Peak multiplied by the particular TSP's approved transmission rate.

The PUC sets the transmission rates that TSPs in ERCOT may charge. Each Transmission/Distribution Utility's transmission fee is based on its costs of providing transmission services. Under PUC rules, each TSP's transmission rate is generally determined by dividing the particular TSP's actual, PUC-approved transmission costs by the total 4-Month Peak for all DSPs in ERCOT in effect on the date of the applicable rate filing. The individual TSP's transmission rates are added together to arrive at the ERCOT postage stamp transmission rate, which, as of August, 2008, was \$22.73 per 4-Month Peak kilowatt, including the Corporation's then current transmission rate of \$3.21584 per 4-Month Peak kilowatt. The ERCOT transmission rate is adjusted as needed to account for the transmission costs of and completed transmission upgrades and improvements made by various TSPs.

In the Fiscal Year ended June 30, 2008, the Corporation collected \$180.7 million in transmission revenues. The Corporation anticipates collecting \$217.7 million in Fiscal Year 2009.

Transformation and Wholesale Metering Revenues. Pursuant to a rate approved by the PUC, the Corporation collects revenues for transformation services, providing transformers that "step down" voltage from levels appropriate for transmission to lower levels for distribution. The PUC has approved a transformation rate of \$0.68889 per kilowatt of billing demand and a twelve-month surcharge for rate case expenses. The transformation rate billing demand for a particular month is the highest hourly kilowatt demand for all of a customer's delivery points in such month and the previous eleven months. The Corporation also charges \$586 per meter per month for wholesale metering service at each delivery substation. The Corporation leases some LCRA wholesale electric customer-owned transformation facilities in order to provide uniform billing, monitoring and other services under the rate, and the Corporation will continue to lease such transformation facilities, at the discretion of each lease customer.

In the Fiscal Year ended June 30, 2008, the Corporation collected \$10.1 million in transformation and wholesale metering revenues. This revenue stream is expected to produce \$13.5 million in Fiscal Year 2009.

Corporation Facilities, Assets and Planned Acquisitions/Expansions

The Corporation owns and/or operates approximately 4,200 miles of transmission lines and 300 substations, including leased facilities, as of June 30, 2008. The transmission lines generally consist of 345 kV, 138 kV and 69 kV transmission facilities, including related facilities. The Corporation also owns and operates various electric transformation facilities which "step down" high voltage power to lower, usable voltages for electric distribution systems. Most of these electric transmission facilities are located in the central Texas region currently served by the wholesale electric customers of LCRA, are operated as part of the ERCOT transmission grid and provide the electrical connections between generators and electric loads in most of the major load centers in the State. These facilities also include leases of transmission facilities from eleven of LCRA's wholesale electric customers, for which the Corporation made annual lease payments aggregating approximately \$11.4 million for the Fiscal Year ended June 30, 2008. The Corporation also owns and operates multiple transmission lines in west Texas and is pursuing the construction of additional related transmission lines. The Corporation also owns certain contracts, easements and personal property which relate to the Corporation's electric transmission and transformation system.

In July 2001, AEP and LCRA entered into a Joint Development Agreement (the "JDA") under which LCRA agreed to assume the financing and ownership responsibilities for certain transmission projects that are in AEP's traditional transmission service area, the service areas of AEP Texas North Company ("AEP North") and AEP Texas Central Company ("AEP Central"). AEP North and AEP Central are subsidiaries of AEP and now provide transmission services to West Texas Utilities Company and Central Power and Light Company, which are now owned by Centrica plc. The JDA was transferred by LCRA to the Corporation. The maximum projected total remaining capital cost for all "in-scope" projects under the JDA for which the Corporation is responsible for Fiscal Years 2009 to 2013 is approximately \$8.6 million. The JDA may be canceled by either party with a six month notice period (though such function shall not impact any "in-scope" project for which project agreements are in affect or existing operation and maintenance agreements) and also provides for liquidated damages of \$7.5 million resulting from terminations for cause by either party.

Under the JDA, AEP or its designee provides engineering, construction, procurement and project management services for each project and also provides operation and maintenance services for an initial term of five years for each such project. The Corporation has the ability to terminate AEP's right to provide such services for cause. The Corporation has the option to make other arrangements for the operation and maintenance services for all projects after the initial five years under the JDA.

LCRA transferred its rights and obligations under the JDA to the Corporation and entered into a guarantee, known as the LCRA JDA Guarantee, with LCRA guaranteeing the Corporation's payment and performance under the JDA, pursuant to State legislation permitting LCRA to enter into such guarantees. The Corporation, in the Initial Contractual Commitment, has obligated itself to reimburse LCRA for any amounts expended by LCRA, over a 24 month period, to the extent LCRA is required to perform under such guarantee. Such payments would constitute a portion of Purchase Price Payments that are payable pursuant to the Initial Contractual Commitment. See "- Initial Contractual Commitment - *Other Purchase Price Payments*" below.

The Corporation, based on its latest capital plan, projects that capital spending will total approximately \$928 million in Fiscal Year 2009 through Fiscal Year 2013, as new facilities are either acquired or built. It is anticipated that the Corporation will continue to act as a regional and statewide electric TSP. See "FACTORS TO BE CONSIDERED IN CONNECTION WITH THE CORPORATION - Capital Spending and Functioning Capital Markets."

In 2005, the State legislature adopted legislation requiring the PUC to designate Competitive Renewable Energy Zones ("CREZ's") in the State in areas in which renewable energy resources and suitable land areas are sufficient to develop generating capacity from renewable energy technologies. Such legislation also required the PUC to develop a plan for the construction of the transmission capacity necessary to deliver the electric output from the renewable energy technologies in such CREZs in a beneficial and cost-effective manner to users of such electricity in the State.

On August 15, 2008, the PUC issued a final order which designated five areas in the western portion of the State as CREZs and established 18,456 MW as the amount of generation capacity within such zones that will need to be transmitted to customers throughout the ERCOT transmission grid. ERCOT has conducted a transmission optimization study that estimates the costs of providing the required transmission for such generation to be \$4.93 billion. The PUC is proceeding with its selection process for awarding transmission facility construction projects to entities to be responsible for the construction of such projects. The selection process is also the subject of a current contested proceeding at the PUC.

On September 12, 2008, the Corporation filed a proposal with the PUC requesting responsibility for the construction of approximately \$737.5 million of CREZ transmission improvements. Of the estimated \$4.93 billion of CREZ facilities, PUC staff has recommended that the Corporation be awarded \$444 million. Also included in the \$4.93 billion are \$459 million of CREZ facilities that are considered upgrades to existing transmission facilities and are classified as "default facilities." On November 6, 2008, the PUC awarded these default facilities to the incumbent TSPs, including an award of \$110 million of such facilities to the Corporation.

The PUC is scheduled to hold a hearing on the merits with respect to the remaining facilities and proposals from all interested TSPs, including the Corporation's proposal, beginning December 1, 2008, to determine CREZ facility construction awards for interested TSPs. Due to its experience as a TSP in the State, the Corporation believes that under criteria set forth in the current PUC rules that it will have the opportunity to construct some portion of the CREZ transmission facilities. However, the Corporation can provide no assurances with respect to whether any such facilities will be constructed by the Corporation or as to the timing of any such construction projects for which the Corporation may be selected. Approximately \$300 million of the \$928 million of anticipated capital expenditures of the Corporation over the next five fiscal years constitutes anticipated CREZ transmission facilities.

The Corporation anticipates that additional Transmission Contract Debt will be issued on a relatively regular basis to fund the above described capital spending. LCRA and the Corporation have authorized and established the Transmission Contract Revenue Notes in an aggregate amount of principal and interest not to exceed \$250 million to be used as permitted in the Controlling Resolution, including (i) to finance a portion of the interest on Transmission Contract Debt and (ii) to finance a portion of the Corporation's ongoing capital expenditures. The Corporation anticipates additional long-term Transmission Contract Debt will be issued every nine to twelve

months, for the foreseeable future, to refund the outstanding balance of such Transmission Contract Revenue Notes.

Management

The Corporation is governed by the Corporation Board, which is presently made up by the entire LCRA Board. See "General" above. The officers of the Corporation, listed below, are the officers of LCRA holding the indicated positions with the Corporation. As discussed in "Business Operations" below, the activities of the Corporation are performed by LCRA pursuant to the Services Agreement.

Corporation Officers

<u>Name</u>	<u>Title</u>	<u>Utility Experience (in years)</u>
Thomas G. Mason	President and Chief Executive Officer	26
W. Brady Edwards	Treasurer and Chief Financial Officer	17
Ross Phillips	Vice President and Chief Operating Officer	18
John W. Rubottom	Secretary and General Counsel	27

Business Operations

The operations of the Corporation are carried out by LCRA's Transmission Services Business Unit staff pursuant to the terms of the Services Agreement. The Services Agreement sets forth the terms and conditions under which LCRA performs, or causes to be performed the operation and maintenance of the transmission assets of the Corporation (except as otherwise provided in the JDA and other similar agreements). LCRA provides design engineering, construction, the traditional general and administrative functions, including finance, accounting, human resources, legal services, purchasing and other related services and in return for such services is paid based on the cost of providing such services. Under the Services Agreement, the Corporation pays, as an operating expense, three percent of its gross revenues to LCRA's Transmission Services Business Unit, which LCRA charges each of its business units to support its continued ability to perform the services required by its statutory mission. Detailed records of time and expenses incurred are maintained in order to insure full cost recovery in future TCOS rate cases. With respect to the portion of the Corporation business that will be done in the former service area of AEP, the operation and maintenance activities will be accomplished by AEP North and AEP Central, respectively, in their service territories, pursuant to agreements with AEP. See "- General" and "- Corporation Facilities, Assets and Planned Acquisitions/Expansions" above.

The Corporation carries insurance to cover general liability and officers' and directors' liability under the umbrella of LCRA's insurance policies. The Corporation has determined, based in part on reports from independent insurance consultants, that due to high cost and limited availability, casualty insurance for operational risks or similar events is not reasonably obtainable by corporations or governmental entities operating like properties. The Corporation currently self-insures relying on its operating reserves and proceeds from short-term borrowings to manage property and casualty risk. With respect to new facilities to be acquired in AEP Central's service territory, risk mapping will be used to determine the tolerance for risk exposure in the coastal regions where windstorm exposure is the greatest.

Initial Contractual Commitment

Summarized below are certain provisions of the Initial Contractual Commitment.

Asset Transfer and Initial Facilities Purchase Price Payments. Pursuant to the terms of the Initial Contractual Commitment, the Corporation is obligated to make certain Initial Facilities Purchase Price Payments to LCRA under the Initial Contractual Commitment in amounts and at the times necessary to allow LCRA to pay its annual LCRA debt service requirements on LCRA debt allocated by LCRA to the Transferred Transmission Assets as reflected on the books and records of LCRA and to pay all expenses and costs of LCRA, including overhead, related to the activities of LCRA under the Initial Contractual Commitment. Initial Facilities Purchase

Price Payments by the Corporation to LCRA under the Initial Contractual Commitment are required to be paid as the first expenses paid from the Gross Revenues of the Corporation.

Additional Transmission Facilities, Issuance of Acquisition Bonds and Additional Purchase Price Payments. The Initial Contractual Commitment provides that LCRA may issue LCRA Additional Indebtedness as Acquisition Bonds to finance Additional Transmission Facilities to be transferred to the Corporation pursuant to a Contract Supplement to the Initial Contractual Commitment or to finance refundings. In return for the conveyance of any such Additional Transmission Facilities or such refundings, the Corporation has covenanted in the Initial Contractual Commitment to make certain Additional Purchase Price Payments to LCRA.

As of the date of this Official Statement, the Corporation's current financial plan does not include financing the activities of the Corporation through the issuance of Acquisition Bonds by LCRA and anticipates that the Corporation's future financing needs will be met by the issuance of Additional Transmission Contract Debt, including one or more series of commercial paper note programs, pursuant to Installment Payment Agreement Supplements and Supplements.

Other Purchase Price Payments. The Initial Contractual Commitment provides that, pursuant to a Contract Supplement, the Corporation will pay Additional Allocated LCRA Plant Purchase Price Payments to LCRA for additional LCRA general plant facilities and equipment, acquired and/or constructed subsequent to the delivery of the Initial Contractual Commitment, allocated on the books and records of LCRA to the Corporation, but owned and operated by LCRA and not transferred to the Corporation. LCRA and the Corporation do not contemplate the execution and delivery of any Contract Supplement in the next twelve months to provide for Additional Allocated LCRA Plant Purchase Price Payments.

The Corporation is also obligated to make certain Rebate Requirement Purchase Price Payments to LCRA at the times and as described in the relevant bond resolution relating to any LCRA Outstanding Tax-Exempt Indebtedness allocated to the Corporation to comply with the Code.

Additionally, the Corporation is also obligated to make certain Guarantee Reimbursement Payments to LCRA in the amounts and the times set forth in the relevant Contract Supplement to reimburse LCRA for amounts expended by LCRA under any LCRA Affiliate Guarantee, including the LCRA JDA Guarantee. The Corporation and LCRA have agreed to execute and deliver a Contract Supplement that amortizes over a two year period at a rate of interest of six percent per annum any amounts expended by LCRA in a particular Fiscal Year pursuant to the LCRA JDA Guarantee. The LCRA Board and the Corporation Board have also determined that the financial projections of the Corporation provide a reasonable basis for determining that the Corporation will have the financial ability to meet its obligations with respect to any such Guarantee Reimbursement Payments. Prior to the delivery of any other Contract Supplement with respect to any other LCRA Affiliate Guarantee, or a modification of a Contract Supplement related to the any LCRA Affiliate Guarantee, the LCRA Board and the Corporation Board must find that the financial projections of the Corporation provide a reasonable basis for determining that the Corporation will have the financial ability to meet its obligations with respect to any particular Guarantee Reimbursement Payments.

Adjustment and Modification of Purchase Price Payments. Purchase Price Payments may be increased or decreased from time to time from the payments reflected in the Initial Contractual Commitment and any Contract Supplement as may be agreed by the LCRA Board and the Corporation Board for certain specified reasons.

LCRA and the Corporation amended the initial schedule of Purchase Price Payments under the Initial Contractual Commitment in March 2003 to reflect the refunding of certain short term commercial paper notes of LCRA attributable to the Transferred Transmission Assets with long-term fixed rate bonds issued by LCRA. The current payment schedule of Purchase Price Payments under the Initial Contractual Commitment is reflected in the table under the heading "CAPITAL CHARGE REQUIREMENTS" below.

Pledge of Gross Revenues to Purchase Price Payments. All Purchase Price Payments (including Initial Facilities Purchase Price Payments, Additional Purchase Price Payments, Additional Allocated LCRA Plant Purchase Price Payments, Rebate Requirement Purchase Price Payments and Guarantee Reimbursement Payments) are payable from a first lien on and pledge of the Gross Revenues of the Corporation and prior to the payment of Installment Payments under the Installment Payment Agreement.

Extraordinary LCRA Optional Purchase Price Payments. Under the Initial Contractual Commitment, the Corporation may additionally be obligated to pay LCRA certain Extraordinary LCRA Optional Purchase Price Payments annually in an amount to be determined by the LCRA Board but in no case in any year will such payment exceed twenty-five percent (25%) of the aggregate total of Initial Facilities Purchase Price Payments, Additional Purchase Price Payments, Additional Allocated LCRA Plant Purchase Price Payments and Guarantee Reimbursement Payments paid by the Corporation under the Initial Contractual Commitment and any Contract Supplement in that Fiscal Year. However, any such Extraordinary LCRA Optional Purchase Price Payments are limited to, and payable solely from, the Gross Revenues of The Corporation received in such Fiscal Year (i.e., excluding any retained revenue fund balance from prior Fiscal Years) after payment of:

- (i) all Purchase Price Payments payable in the applicable Fiscal Year;
- (ii) all of the expenses of operation and maintenance of the Corporation payable in the applicable Fiscal Year, including any payments due to LCRA pursuant to any services agreement between LCRA and the Corporation;
- (iii) the annual debt service on any debt or other obligations (including any payments under a contract supporting any debt issued by LCRA or any other party on behalf of the Corporation) of the Corporation due in the applicable Fiscal Year; and
- (iv) the amount of all payments required for any Capital Charge coverage ratios required by the financial policies of the Corporation and to otherwise accumulate the required funds in any debt service reserve fund related to any debt or other obligations of the Corporation or any other funds required any agreement or the financial policies of the Corporation (which may be amended from time to time at the sole discretion of the Corporation) due in the applicable Fiscal Year.

Budget. The Initial Contractual Commitment requires the Corporation to appropriate in each annual budget an amount sufficient to pay all amounts required under the Initial Contractual Commitment and any Contract Supplement.

Rate Covenant. The Corporation has agreed throughout the term of the Initial Contractual Commitment to fix and collect such rates and charges for services to be supplied by or use of the Transmission Facilities of the Corporation, in each Fiscal Year, as will produce Gross Revenues at all times in an amount at least equal to the sum of:

- (i) all Purchase Price Payments payable in the applicable Fiscal Year;
- (ii) all of the expenses of operation and maintenance of the Corporation payable in the applicable Fiscal Year, including any payments due to LCRA pursuant to any services agreement between LCRA and the Corporation;
- (iii) 25% of the annual sum of all Purchase Price Payments due in the applicable Fiscal Year;
- (iv) 1.00 times the annual debt service on any debt or other obligations (including any payments under a contract supporting any debt issued by LCRA or any other party on behalf of the Corporation) of the Corporation due in the applicable Fiscal Year; and
- (v) the amount of all payments required to meet any Capital Charge coverage ratios required by the financial policies of the Corporation and otherwise accumulate the required funds in any debt service reserve fund related to any debt or other obligations (including any payments under a contract supporting any contract revenue debt issued by LCRA or any other party on behalf of the Corporation) of the Corporation or any other funds required by any agreement or the financial policies of the Corporation (which may be amended from time to time at the sole discretion of the Corporation).

However, if in any Fiscal Year the Corporation uses its best efforts to obtain approval from the PUC, or any successor agency, of rates and charges for its facilities and services in the amounts and as required by the Initial Contractual Commitment and the Corporation's financial policies, and such approved rates and charges are not

sufficient for the Corporation to produce Gross Revenues necessary to meet the requirements specified in the preceding paragraph, such event does not constitute a failure to comply with such covenants as long as Gross Revenues for that Fiscal Year are sufficient to meet the requirements of (i), (ii), (iv) and (v) in the preceding paragraph above. In such an event, LCRA may, however, immediately require the Corporation to prepare a TCOS rate case with the PUC to seek recovery of such deficiencies. However, the Corporation may not be required to file a new TCOS rate case before the PUC within twelve months of it having filed a similar TCOS rate case. In addition, LCRA may also require the Corporation to engage an independent professional electric utility consultant for consulting work related to electric utility cost of service proceedings selected by LCRA to assist the Corporation.

Events of Default and Remedies. Upon the occurrence and continuation of an event of default under the Initial Contractual Commitment, LCRA may elect to exercise a wide range of remedies, including foreclose on the Deed of Trust, Mortgage and Security Agreement or conveyance documents in lieu of foreclosure. Upon the occurrence of any event of default under the Initial Contractual Commitment that results in a foreclosure under the Deed of Trust, Mortgage and Security Agreement, LCRA is required to accelerate all Purchase Price Payments such that they immediately become due and payable provided that LCRA also accelerates all Installment Payments.

TCOS Rate Proceedings

All TSPs, including the Corporation, are required by PUC rules to regularly justify their effectiveness through a combination of annual earnings monitoring reports or periodic TCOS rate cases. Based on such reports, filings and proceedings, the PUC must determine the reasonableness of each TSP's costs and establish the revenue that each TSP is entitled to recover in its transmission rate. In making its decisions, the PUC may consider input from transmission service customers and other interested electric market participants. The PUC staff and other interested parties have the right to challenge the reasonableness of the Corporation's transmission costs.

Under PUC rules, each TSP's transmission rate is generally determined by dividing the particular TSP's actual, PUC-approved transmission costs by the total 4-Month Peak for all DSPs in ERCOT in effect on the date of the applicable rate filing. Each DSP then makes a monthly payment to each TSP in the State equal to 1/12 of the DSP's current 4-Month Peak multiplied by the particular TSP's approved transmission rate.

PUC rules allow the Corporation, as a TSP, to file a TCOS rate case with the PUC as frequently as the Corporation deems necessary in which all costs for a test year, adjusted to include the latest known debt service for the Corporation, are subject to review and inclusion in its transmission rates.

PUC rules also allow the Corporation to annually file an interim capital additions update to its TSP transmission rate for the cost of new facilities that have become operational in the ERCOT transmission grid since the Corporation's last TCOS rate case to be included in its transmission rate as recoverable costs. The PUC applies the standard that only the invested capital costs, the previously approved rate of return, depreciation, local property taxes, federal income taxes and other associated taxes related to electric transmission facilities which have become operational since the last TCOS rate case are eligible to be included as recoverable costs. An interim capital additions update may not be used to include additional operation and maintenance costs in a TSP's transmission rate. Costs approved in an interim capital additions update would be subject to reconciliation as part of the Corporation's next TCOS rate case. See "DESCRIPTION OF THE TRANSMISSION REGULATORY SCHEME WITHIN ERCOT - Participants in the Electric Transmission Scheme within ERCOT- *Transmission Service Providers*" below.

As discussed in "Corporation Facilities, Assets and Planned Acquisitions/Expansions" above, the Corporation is undertaking a significant capital program. The Corporation has indicated that it may defer filing TCOS rate cases for certain periods during its capital program. During such periods, the Corporation expects to mitigate the financial impact of deferring the filing of such TCOS rate cases by filing one or more interim capital additions updates to its transmission rate to incorporate the cost of newly operational transmission projects into its transmission rate and to otherwise actively manage its operation and maintenance and other costs that cannot be included in rates pursuant to an interim capital additions update. Under certain circumstances, such an approach may impact the Corporation's debt service coverage. See "FACTORS TO BE CONSIDERED IN INVESTING IN CONNECTION WITH THE CORPORATION - Regulatory and Rate Timing Risk". The Corporation expects to actively

manage the risks associated with such strategy and to file a TCOS rate case at such times as it deems necessary and prudent.

The Corporation also anticipates filing transformation rate cases on an as needed basis with respect to its transformation rate.

2007 - 2008 TCOS Rate Case. On November 15, 2007, the Corporation filed a TCOS rate case with the PUC requesting an increase to cover rising costs for transmission, transformation and metering. The TCOS rate case requested a cost of service of \$227 million, representing an increased revenue requirement of \$82 million, a 57 percent increase over the \$143.7 million cost of service approved in the Corporation's previous TCOS rate case. Since the filing of the Corporation's previous TCOS rate case in November 2003, the Corporation's operating expenses have increased by 15 percent and the Corporation has completed more than \$558 million in new or upgraded assets such as transmission lines and substations to keep up with the electric demands placed on the Texas electric grid by population increases and economic expansion. The TCOS rate case also included a request to increase by 53 percent the Corporation's rate for transforming electricity into lower distribution levels and its rate for metering, which are paid by wholesale electric customers and other electric utilities.

On April 23, 2008, the State Office of Administrative Hearings issued an order accepting a settlement between the Corporation, the PUC staff and the intervening parties in the TCOS rate case which approved the Corporation's request to implement interim rates set at a stipulated \$222.8 million revenue requirement effective April 20, 2008. On June 11, 2008 the PUC issued the final order accepting the settlement along with the effective date of Corporation's final rates.

2003-2005 TCOS Rate Case. On November 17, 2003, the Corporation filed a TCOS rate case with the PUC that involved a contested hearing, unlike prior TCOS rate cases of the Corporation (and other TCOS rate cases of LCRA since 1995). On April 5, 2005, the PUC issued its final order with respect to such case, which concluded that: 1) a return methodology utilizing the debt service coverage method with a debt service coverage ratio of 1.50 times is reasonable, 2) the JDA and its costs are reasonable, 3) LCRA's utilization and control of the Corporation are reasonable and in compliance with State law, 4) staffing levels should not be adjusted and operation and maintenance expenses were approved with minor disallowances, and 5) LCRA's overhead cost allocations to the Corporation are reasonable.

In addition, the final order directed that an independent management audit evaluate the manner by which the Corporation and LCRA conduct business, including the management of all construction projects conducted by outside contractors or managed by outside project managers, the calculation of operation and maintenance expenses, construction and engineering, and transactions between the Corporation and LCRA. The audit report was completed in 2006 and provided the PUC with additional information about the appropriateness of charges made to and against the Corporation, and the report contained 14 recommendations regarding controls, safeguards, allocation modifications, account assignments and peer utility surveys. The Corporation's Board has accepted the report's recommendations and provided for their implementation. The Corporation believes that the implementation of the report's recommendations will not have a material adverse effect on its operations.

Latest TCOS Rate Proceeding. On July 25, 2008, the Corporation filed an interim capital additions update with a new interim transmission rate which became effective in October 2008. The Corporation requested and received an additional \$8.6 million in interim annual transmission revenues which increased the Corporation's annual revenue requirement from \$222.8 million to \$231.4 million.

Anticipated Future TCOS Rate Proceedings. The Corporation currently has no plans to file another TCOS rate proceeding until making its next rate case filing, which is not anticipated to be filed until the last quarter of calendar year 2010. No assurances can be given, however, that the Corporation will adhere to this schedule.

Financial Policies

The Corporation's financial policies, described below and approved by the Corporation Board, serve as a framework from which the Corporation will maintain financial integrity while serving the long-term interests of LCRA, transmission customers of the Corporation and other constituencies. The Corporation Board has reserved the right to amend and modify its financial policies from time to time and without notice.

The Chief Financial Officer of the Corporation will prepare a business plan consistent with the financial policies. The business plan will provide current financial information and a five-year projection.

The Corporation's financial policies provide that revenue requirements in the Corporation's business plans will be set to target a minimum Capital Charge coverage ratio of 1.25 times the total of (i) any Purchase Price Payments under the Initial Contractual Commitment and (ii) debt service for all debt obligations of the Corporation, including Transmission Contract Debt. The Corporation's financial policies provide that higher levels of Capital Charge coverage may be appropriate in periods of rapid growth and capital investment and to mitigate possible regulatory lag resulting from the incurrence of debt and operating and maintenance expenses prior to such costs being included in costs approved in a TCOS rate case before the PUC. The Corporation's financial policies provide, that in the event that the overall Capital Charge coverage is below 1.25 times for any Fiscal Year, the Corporation Board will promptly implement a plan, to be recommended by the executive management of the Corporation, which could include filing a TCOS rate case to seek approval of additional costs and rate increases, cost reductions or other means to achieve a Capital Charge coverage ratio of 1.25 times.

The Corporation's financial policies provide that revenue levels will be evaluated in consideration of, but not limited to, such things as bond ratings, capital requirements, current business conditions, economic projections and load-growth assumptions, delays inherent in the PUC regulatory process, and the projected size and frequency of necessary TCOS rate cases before the PUC to achieve rate adjustments. The Corporation's financial policies provide that the Corporation will use its best efforts to obtain regulatory approval of rates and prices that cover the cost of specific services, allow it to be self-supporting, and provide a stable and predictable flow of revenues. The Corporation's financial policies provide that rate adjustments, as needed to maintain appropriate levels of revenue, will be reasonably structured to achieve these goals. The Corporation's financial policies provide that these revenues will be adequate to cover Operating and Maintenance Expenses (including the LCRA statutory requirements funding obligation to LCRA, currently three percent of gross revenues), debt service and coverage and, to the extent possible, the capital budget.

The Corporation's financial policies provide that the Corporation may structure debt issues to finance capital additions and improvements such that the average maturity of the debt funding the assets approximates the average life of the assets financed; however, debt issues may be structured with a shorter average maturity if economically justified. The Corporation's financial policies provide that the Corporation will build equity that will maintain appropriate access to capital markets and is consistent with regulatory guidance.

The Corporation's financial policies also provide that the Corporation will build appropriate target levels of operating reserves as follows: six months of average debt service on all outstanding debt of the Corporation, excluding any Purchase Price Payments by the Corporation to LCRA pursuant to the Initial Contractual Commitment, and two months of average operating and maintenance expenses, including those billed by LCRA. The Corporation's financial policies provide that such amounts shall be available for extraordinary operating and maintenance expenses, capital additions and/or debt service of the Corporation.

The Corporation's financial policies provide, after the initial period during which the operating reserves, on a rolling five year basis, are funded, if at any time the level of reserves are less than the target levels set forth in the financial policies, the Corporation Board will promptly implement a plan, to be recommended by the executive management of the Corporation, to increase rates, reduce costs, or otherwise cause there to be sufficient revenues to replenish the level of reserves to such target levels within 24 months. The Corporation may periodically retire Transmission Contract Debt with available funds, if any, when it determines that it is economically advantageous to do so.

The Corporation's financial policies provide that in order to diminish the rate impacts of capital additions and other construction projects until they are placed in operation and/or the costs thereof have been approved by the PUC in a TCOS rate case, the Corporation may capitalize interest for an appropriate period of time, not to exceed statutory limits.

The Corporation's financial policies provide that the amount of variable rate debt of the Corporation will not exceed 25% of the sum of the Corporation's total equity and the Corporation's long-term debt (as reflected in the Corporation's most recent audited annual financial statements).

The Corporation's financial policies provide that if property and casualty insurance is unavailable for Corporation facilities, or if the Corporation determines to otherwise self-insure, the Corporation may self-insure against such risks and utilize operating reserves of the Corporation for such self insurance. Additionally, the Corporation may utilize short-term borrowings to cover such risks. See "- Business Operations" above.

Corporation Business Plan and Management Discussion

In addition to the following discussion, APPENDIX D hereto contains "Management's Discussion and Analysis" for Fiscal Year 2008 and 2007, which should be read in conjunction with such discussion.

The Corporation's business plan reflects a significant growth initiative focused solely on regulated electric transmission services. Over the next five years, the Corporation anticipates significant growth in its gross asset base, adding approximately \$928 million to its \$1.46 billion in capital assets, as of June 30, 2008. The Corporation expects to increase its total miles of transmission lines in service from approximately 4,200 as of June 30, 2008 to approximately 4,300 in Fiscal Year 2013, excluding any possible CREZ transmission facilities that the Corporation may construct. The projects are being driven, in large part, by the increased demand within LCRA's current electric service area resulting from growth within ERCOT as well as among LCRA's wholesale electric customers and, to a lesser degree, the Corporation's transmission business throughout the ERCOT system. See "Corporation Facilities, Assets and Planned Acquisitions/Expansions" above. The Corporation anticipates that it will require significant capital over the next five years and that it will likely be accessing the capital markets on a regular basis to obtain a large majority of such capital.

In order to implement the capital projects in the time frame contemplated, the Corporation will be required to initiate project construction prior to the individual project costs being recoverable in rates approved by the PUC. The Corporation will manage its risk by only initiating construction on projects that have obtained a CCN from the PUC or on projects that do not require a CCN and by capitalizing interest until costs of the projects are incorporated into transmission rates. In addition, the JDA with AEP applies only to projects that have been recommended by the PUC or ERCOT or are required transmission interconnections with new electric generation facilities (unless otherwise agreed by AEP and the Corporation). This mitigates the risk that investments will be made in projects the cost of which could be disallowed by the PUC. See "Corporation Facilities, Assets and Planned Acquisitions/Expansions" above.

The Corporation's business plan reflects revenues of approximately \$234.7 million in Fiscal Year 2009 and operation and maintenance expenses of approximately \$79.6 million.

Capital spending is projected to total approximately \$928 million over the next five fiscal years. The Corporation anticipates that approximately \$687 million of such capital projects will be financed with debt and that the remainder will be funded with available revenues of the Corporation. For Fiscal Year 2009, the Corporation plans capital spending of approximately \$128 million with approximately \$36.8 million of which to be funded from revenues. It is expected that the Corporation will be able to finance planned construction and possible acquisitions through the issuance of Additional Transmission Contract Debt.

LCRA and the Corporation have authorized and established the Transmission Contract Revenue Notes in an aggregate amount of principal and interest not to exceed \$250 million to be used as permitted in the Controlling Resolution, including, in part, to finance additional electric transmission and transformation projects.

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Selected Financial Information

Set forth below is the Statements of Revenues, Expenses, and Changes in Equity of the Corporation for the Fiscal Years ended June 30, 2004 through June 30, 2008 prepared in accordance with Government Accounting Standards Board Statement" No. 34, "Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments." The financial information included below has been derived from the audited financial statements contained in APPENDIX D to this Official Statement.

Fiscal Year
Ended June 30,

	<u>(Dollars in Thousands)</u>				
	<u>2004</u> ⁽¹⁾	<u>2005</u> ⁽¹⁾	<u>2006</u>	<u>2007</u>	<u>2008</u>
Operating Revenues					
Transmission	\$ 110,639	\$ 142,707	\$ 156,249	\$ 169,013	\$ 180,164
Transformation	8,581	8,524	8,973	9,178	9,753
Other	<u>42</u>	<u>131</u>	<u>614</u>	<u>635</u>	<u>822</u>
Total Operating Revenues	<u>\$ 119,262</u>	<u>\$ 151,362</u>	<u>\$ 165,836</u>	<u>\$ 178,826</u>	<u>\$ 190,739</u>
Operating Expenses					
Operations	52,665	57,528	51,988	61,269	66,631
Maintenance	9,459	8,805	10,370	9,669	9,372
Depreciation and amortization	<u>21,432</u>	<u>25,581</u>	<u>32,937</u>	<u>35,067</u>	<u>38,661</u>
Total operating expenses	<u>83,556</u>	<u>91,914</u>	<u>95,295</u>	<u>106,005</u>	<u>114,664</u>
Operating income	35,706	59,448	70,541	72,821	76,075
Non-Operating Revenues (Expenses)					
Interest and other income	543	2,730	3,353	10,215	4,539
Interest and other expenses	<u>(34,545)</u>	<u>(52,590)</u>	<u>(55,481)</u>	<u>(68,453)</u>	<u>(81,531)</u>
Total non-operating revenues (expenses)	<u>\$ (34,002)</u>	<u>\$ (49,860)</u>	<u>\$ (52,128)</u>	<u>\$ (58,238)</u>	<u>\$ (76,992)</u>
Income (loss) before costs to be recovered from revenues, capital contributions, special item and transfers in	1,704	9,588	18,413	14,583	(917)
Costs to be Recovered from Revenues	10,572	11,429	1,419	1,269	25,397
Capital Contributions	<u>2</u>	<u>99</u>	<u>2,384</u>	<u>1,859</u>	<u>1,132</u>
Income before transfers in and special item	12,278	21,116	22,216	17,711	25,612
Transfers In	806	276	829	842	726
Special Item-Loss on Early Defeasance of Debt	<u>-</u>	<u>-</u>	<u>(1,323)</u>	<u>(1,356)</u>	<u>-</u>
Change in Equity	13,084	21,392	21,722	17,197	26,338
Total Equity, Beginning of Period	<u>83,918</u>	<u>97,002</u>	<u>118,394</u>	<u>140,116</u>	<u>157,313</u>
Total Equity, End of Period	<u>\$ 97,002</u>	<u>\$ 118,394</u>	<u>\$ 140,116</u>	<u>\$ 157,313</u>	<u>\$ 183,651</u>

⁽¹⁾ Transmission revenues recognized during June 2004 through March 2005 reflect a transmission rate of \$2.33 per 4-Month Peak kilowatt out of a higher PUC approved interim transmission rate collected by the Corporation during the pendency of the Corporation's 2003-2005 TCOS rate case. Such revenues do not reflect the final PUC approved transmission rate determined in such TCOS rate case of \$2.5475 per 4-Month Peak kilowatt. The Corporation recognized the revenues resulting from such rate differential in May 2005.

The following Capital Charge Coverage Ratio calculation is unaudited.

Capital Charge Coverage Ratio

(Dollars in Millions)	Fiscal Year Ended June 30				
	2004	2005	2006	2007	2008
Funds Available for Capital Charges ⁽¹⁾	\$ 54.2	\$ 81.6	\$ 101.8	\$ 110.6	\$ 114.1
Capital Charges					
Contractual Commitment to LCRA	\$ 31.7	\$ 32.5	\$ 31.4	\$ 31.2	\$ 30.5
Debt Service on Contract Revenue Bonds	7.2	22.8	37.4	38.6	48.8
Total Capital Charges	\$ 38.9	55.3	\$ 68.8	\$ 69.8	\$ 79.3
Capital Charge Coverage Ratio ⁽²⁾	1.39x	1.48x	1.48x	1.58x	1.44x

(1) Funds available for capital charges equals transmission, transformation and metering revenues plus interest income from unrestricted funds less operation and maintenance expenses.

(2) For certain Fiscal Years, coverage levels are less than 1.50 times debt service due to a number of factors, including (i) decisions by the Corporation not to file TCOS rate cases annually, (ii) the interest rates on new Transmission Contract Debt exceeding interest rates used in the last TCOS rate case and/or (iii) operation and maintenance expenses exceeding such expenses in the last TCOS rate case. See "FACTORS TO BE CONSIDERED IN CONNECTION WITH THE CORPORATION- Regulatory and Rate Timing Risk."

FACTORS TO BE CONSIDERED IN CONNECTION WITH THE CORPORATION

Regulatory and Rate Timing Risk

The Corporation's cash flows, including its ability to meet any coverage requirements, will be affected by the Corporation's ability to include capital costs in rates through either a TCOS rate case or an interim capital update. See "THE CORPORATION - General," "- TCOS Rate Proceedings," and "- Corporation Business Plan and Management Discussion." Factors which could adversely affect the Corporation's ability to include capital costs in rates through either a TCOS rate case or an interim capital update include (a) failure to timely file for either a TCOS rate case or an interim capital update, (b) a protracted TCOS rate case, (c) disallowance of costs by the PUC in a TCOS rate case, (d) if costs are included in the Corporation's transmission rate pursuant to an interim capital additions update and then disallowed by the PUC in a subsequent TCOS rate case, requiring the Corporation to reimburse the corresponding amounts it had collected using the rate allowed by the prior interim capital additions update, (e) a change in the method of calculating or a reduction in the rate of return in a TCOS rate case, (f) failure to complete capital project on a timely basis, (g) realized capital costs being less than the related budgeted costs, or (h) the retirement of existing capital assets.

The Corporation's cash flows, including its ability to meet any coverage requirements, will also be affected with respect to any capital costs included in rates through an interim capital update to the extent that (a) the Corporation's operation and maintenance expenses in the period between TCOS rate cases or the filing of interim capital additions updates exceed the amount of such expenses included in the Corporation's last approved transmission rate, (b) fluctuations in property taxes occur in between filings of interim capital additions updates to its TSP transmission rate and the filing of its next TCOS rate case or (c) the interest rates on any new Transmission Contract Debt are higher than the interest rates included in the rate year debt service in the Corporation's prior TCOS rate case.

The Corporation will be required to rely on reserves or commercial paper to the extent that rates calculated in the forgoing manner are insufficient to cover all of the Corporation's costs. In order to meet such minimum coverages, the Corporation may be required to file a TCOS rate case earlier than anticipated or to reduce expenses, including by means of the deferral of maintenance and other cost reduction measures, that may affect the Corporation's operational performance of its business activities.

Corporation to Self Insure

The Corporation currently self insures all casualty and property risks. The Corporation does not maintain business interruption insurance. Other than available Corporation funds and its operating reserves, the Corporation has not established and does not have available any cash reserves to cover these risks. General Counsel of LCRA is of the opinion that the Corporation, as an affiliated nonprofit corporation of LCRA, is entitled to the same general governmental immunity of LCRA from tort liability. The repair and/or replacement of any substantial property damage resulting from a casualty event would have to be paid from available Corporation funds or financed from the proceeds of Transmission Contract Debt or by LCRA if it determines, in its sole discretion, to issue LCRA debt pursuant to a Contract Supplement to the extent that available funds of the Corporation are insufficient for such purpose. See "THE CORPORATION - Initial Contractual Commitment."

Capitalized Interest

The Corporation intends from time to time to use proceeds from the sale of certain Transmission Contract Debt, including the Transmission Contract Revenue Notes, to make interest payments on various series of Transmission Contract Debt until such time as various transmission and transformation projects attributable thereto are incorporated into the Corporation's rates through filings with the PUC. If the completion of the various portions of such projects is significantly delayed or there is a delay in having the costs thereof incorporated into rates the Corporation may have to continue to capitalize interest, and the Corporation's cash flow could be adversely impacted.

Reliance on DSP Payments

The Corporation, as a TSP, must rely upon payments from and assume the credit risk of the DSPs. DSPs are, in turn, reliant upon payments from and assume the credit risk of REPs. A bankruptcy of or payment default by one or more DSP could adversely affect the Corporation's cash flow. Under PUC rules at least 65 days must elapse after billing for service received before a DSP will be in default. The failure of any DSP to make any required payments, including DSPs to which the Corporation has not provided service, is borne ratably by all TSPs, including the Corporation. Additionally, while the PUC rules permit a TSP to establish reasonable creditworthiness standards to be applied to all DSPs, neither LCRA, the Corporation nor, to the Corporation's belief, any other TSP has established any such DSP credit standards. See "DESCRIPTION OF THE TRANSMISSION REGULATORY SCHEME WITHIN ERCOT - Payment of Transmission Revenues - Payment of TSPs by the DSPs."

Mandated Transmission Improvements

Upon the recommendation of the ISO of ERCOT, the PUC may require the Corporation to make improvements to its transmission system to alleviate congestion constraints. In addition, the Corporation is responsible for connecting new generating facilities to the transmission system in LCRA's service territory. The Corporation will be required to finance any mandated improvements to its transmission system and to seek to recover such costs in a TCOS rate case before the PUC. If in any TCOS rate case, the Corporation does not recover its costs relating to interconnecting a generating facility, the Corporation will have to seek recovery of such costs from the owner of such facility under an interconnection agreement.

Capital Spending

As noted herein, the Corporation has identified approximately \$928 million of capital spending from Fiscal Year 2009 through Fiscal Year 2013. Approximately 74% of such expenditures are anticipated to be debt financed. The Corporation's growth will be dependent on the Corporation's ability to access the capital markets to provide funds for such purposes. See "THE CORPORATION - Corporation Facilities, Assets Planned Acquisitions/Expansions" and "- Corporation Business Plan and Management Discussion."

The credit markets have experienced substantial disruption over the course of the preceding year. There can be no assurance as to the timing or the extent of the recovery that may be made by the credit markets. If the Corporation is unable to access the credit markets as a result of the disruptions that have been experienced, the Corporation may have to delay certain capital improvements until such time as the capital markets rebound. The effect of such delays could result in increased costs for such improvements and a resulting delay in the receipt of revenues related to such improvements.

DESCRIPTION OF THE TRANSMISSION REGULATORY SCHEME WITHIN ERCOT

Overview

Briefly, SB 7 provided for the deregulation of electric power generation and allowed retail electric customers of IOUs within ERCOT to choose their own electric provider as of January 1, 2002, as well as retail customers of those Municipal Utilities and Electric Coops within ERCOT that elect, on or after January 1, 2002, to participate in retail electric competition. SB 7 also required electric utilities, including LCRA, to unbundle their electric generation, transmission/distribution and retail electric sales functions into separate companies by January 1, 2002. After January 1, 2002, the unbundled electric transmission and distribution companies continue to be regulated by the PUC. The deregulation of the retail electric market, referred to as "customer choice" in the administrative rules of the PUC, and the unbundling by utilities of electric generation, electric transmission/distribution and retail electric sales functions into separate companies has had a direct impact on the new regulatory scheme governing electric transmission and distribution within ERCOT.

The unbundling requirements of SB 7 have resulted in the creation of new, separate Transmission/Distribution Utilities. A Transmission/Distribution Utility may potentially provide electric transmission services and/or electric distribution services. Transmission/Distribution Utilities, Municipal Utilities and Electric Coops are classified as either TSPs to the extent that they operate power lines at a voltage of 60,000 volts or above, or as DSPs to the extent that they operate power lines at a voltage of below 60,000 volts. A Transmission/Distribution Utility may be both a TSP and a DSP.

The implementation of customer choice by SB 7 has also resulted in the creation of REPs that serve as the billing entities for the end use retail customers in those IOU areas where customer choice is available to retail electric customers, primarily the former IOU service areas.

The following discussion is a description of the Texas transmission regulatory scheme within ERCOT in which Transmission/Distribution Utilities conduct their business operations, including their relationships between the various parties in the new regulatory scheme.

Participants in the Electric Transmission Scheme within ERCOT

ERCOT. ERCOT is the independent nonprofit organization that ensures the reliability and security of the transmission of electricity within its region in the State. The ERCOT reliability region serves about 85% of the electrical load in the State and 75% of the geographic area in the State over an interconnected 38,000-mile electric transmission power grid and has an overall generating capacity of 71,812 MW. ERCOT is one of 8 regional reliability organizations in the North American Electric Reliability Corporation ("NERC"). As a NERC member, the primary responsibility of ERCOT is to facilitate reliable electric transmission grid operations in the ERCOT region by working with the region's electrical energy industry organizations. The PUC has primary jurisdictional authority over ERCOT to ensure the adequacy and reliability of electricity across the state's main interconnected power grid and ERCOT's finances and operations. ERCOT is governed by an independent board of directors comprised of electric utility market participants as well as two directors who are not affiliated with the electric industry. ERCOT's members include retail consumers, IOUs, Municipal Utilities, Electric Coops, river authorities such as LCRA, independent power producers, competitive retailers, and power marketers. ERCOT is the only reliability region in North America that is located completely within the borders of a single state, and it is one of two reliability regions that are also independent system operators of their respective transmission grids within such regions.

ERCOT, as the ISO, manages the electric transmission grid, which links the electric generation facilities within ERCOT to the distribution systems for, and end users of, such electric power. The ERCOT transmission grid is regulated entirely by the PUC which also regulates all TSPs within ERCOT. Other electric reliability councils, such as the Southwest Power Pool, serve areas in the Texas panhandle, east Texas and west Texas. Individual electric utilities own sections or components of the ERCOT transmission grid and are responsible for operating and maintaining their own transmission lines and equipment. The ISO coordinates the operation of the transmission grid to ensure its reliability, and ERCOT coordinates with the various transmission owning electric utilities to make sure the transmission system meets the needs of the State's ERCOT electric market.

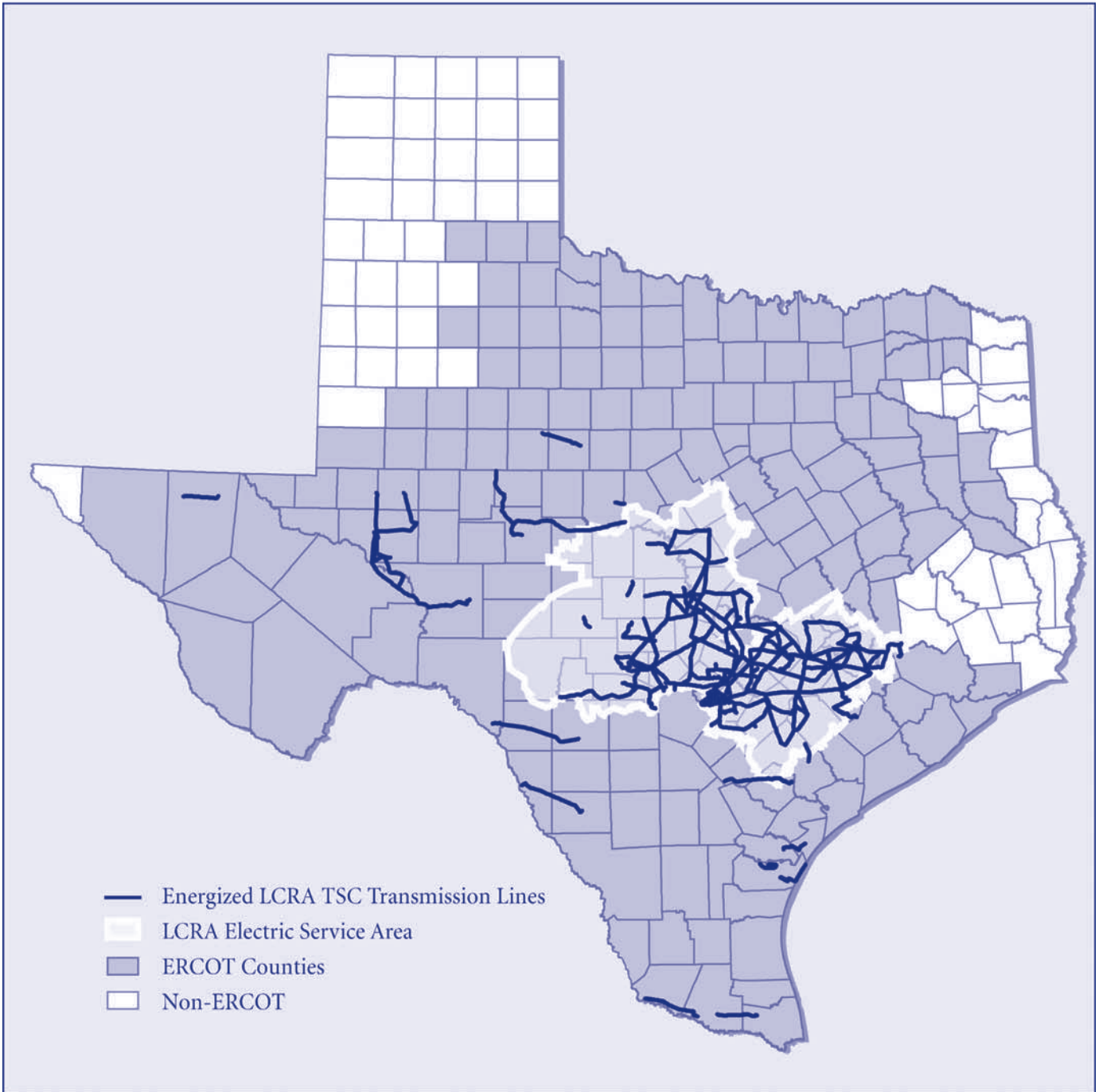
In addition to transmission reliability and open wholesale access, ERCOT is also charged with overseeing the electric power transactions within its boundaries, including the development and effective operation of the majority of the State's competitive retail market. In the deregulated market, ERCOT is the central controller of the majority of the energy market's activities, including power scheduling and troubleshooting. As the ISO, ERCOT serves as an independent, unbiased third-party entity that oversees the activities related to the reliable and safe transmission of electricity within ERCOT's boundaries and provides the platform for an open, competitive marketplace. ERCOT is required to perform four primary functions as the ISO: (1) ensure non-discriminatory access to the transmission and distribution systems for all electricity buyers and sellers; (2) ensure the reliability and safety of the regional electric network around-the-clock; (3) ensure that information related to customer retail choice is provided in a timely manner; and (4) ensure that electricity production and delivery are accurately scheduled among all regional generators and wholesale buyers and sellers.

ERCOT's duties are categorized into four primary operations: production operations, market operations, financial operations, and registration. Production operations involves system security, planning, and market support. In performing its responsibilities, ERCOT monitors and analyzes all of the power grid's electricity transmission components every two to four seconds for status, load and output to ensure the reliable and safe transmission of electricity. Market operations includes maintaining the intricate balance between forecasted electricity power generation schedules and actual electricity demands among all competing market participants. In this process, ERCOT conducts detailed studies of the estimated generation and demand requirements of the electric marketplace for every 15-minute interval of each day. Plus, as the appointed "procurer of last resort," ERCOT assesses the ancillary services required to ensure reliable electricity production for the actual demand at any moment. Then it procures extra ancillary services to be on standby to ensure electric reliability when and if there are gaps between forecasted and actual electricity usage. Financial operations includes client relations, meter acquisition and data aggregation, settlements, billing, business rules, registration, load profiling, and renewable energy credit program management. It is the responsibility of ERCOT's settlement and customer service section to maintain the intricate balance between forecasted power generation schedules and actual electricity demand among all competing market participants. ERCOT also assesses, schedules and acquires ancillary service requirements to ensure electricity supplies reliably serve actual demand at any moment-around-the-clock. ERCOT is also the centralized registration agent for both retail premises and market participants in the ERCOT transmission grid.

Set forth below is a map illustrating the relative position of LCRA's electric service area, where a majority of the Corporation's electric transmission assets are located, within ERCOT and the location of the Corporation's operational electric transmission lines. ERCOT has only a total of 800 MW of direct current interconnections with other power pools. Historically and at present, the ERCOT transmission grid has operated as an "island," whereby no significant amounts of electric power have been imported into or exported from the ERCOT transmission grid.

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LCRA Transmission Services Corporation Transmission Lines Serving the Electric Reliability Council of Texas



Transmission Service Providers. As noted above, the TSPs provide transmission services within ERCOT by providing transmission of "wholesale" electric power over electric power lines that carry electricity at 60,000 volts or more. The transmission lines provided by all of the TSPs within ERCOT collectively make up the ERCOT transmission grid. Pursuant to PUC rules, TSPs are required to plan, construct, operate and maintain their transmission systems in accordance with good utility practice in order to provide transmission service customers with transmission services over their transmission systems. TSPs must also endeavor to construct and place into service sufficient transmission capacity in accordance with good utility practice to ensure the adequacy and reliability of the ERCOT transmission network in order to deliver power to the loads of the transmission service customers. TSPs are also required to plan, construct, operate and maintain transmission facilities needed to relieve transmission constraints as recommended by ERCOT and approved by the PUC. Presently, there are 40 TSPs within ERCOT, which may include other TSPs who, similar to LCRA's transmission-owning wholesale electric customers, have leased transmission facilities to a primary TSP.

SB 7 directs the PUC to determine electric transmission open access transmission rates on a 100% "postage stamp" pricing methodology. TSPs in ERCOT are required to charge rates approved by the PUC and reflected in approved tariffs for transmission service. Approved rates are designed to recover for the TSP its revenue requirement. A TSP may change its rates in two ways.

First, a TSP may file a TCOS rate case, in which all of its expenses and its cost of capital are reviewed. It may file a TCOS rate case whenever it determines that revenues under its previously approved tariff are insufficient to recover its expenses and capital costs. The TSP's proposed cost of service rates in the tariff are based upon the TSP's cost of rendering service to the public during a historic test year, adjusted for "known and measurable changes" occurring after the close of the test year. The historic test year is typically the most recent and representative 12 month period prior to filing. Such "known and measurable changes" would include new transmission facilities that the TSP can demonstrate with reasonable certainty will be placed into service by the time the new rates would become effective, as well as recurring operating and maintenance expenses, such as increased labor costs, that have begun to be incurred after the historic test year.

The PUC currently allows the proposed cost of service rates in a TCOS rate case to contain a component based on certain allowable expenses of the TSP and a component based on a return on investment. The PUC defines "allowable expenses" as expenses of the TSP that are reasonable and necessary to provide service to the public, including operation and maintenance expenses; depreciation expenses; assessments and taxes; federal income taxes; and certain other reasonable and necessary expenses of the TSP. By PUC rule, certain expenses are never allowed as a component of the cost of service, including lobbying expenses, political contributions and certain other expenditures not in the public interest. The PUC also allows the cost of service rates to include a component based on a rate of return or debt service with a level of coverage reasonably sufficient to assure confidence in the financial soundness of the TSP and adequate under efficient and economical management to maintain and support its credit and enable it to raise money necessary for the proper discharge of its public duties.

Based on these two components, the PUC approves the tariff and sets an authorized annual charge that is divided by twelve to produce a monthly rate for the TSP's transmission services. A TSP's monthly transmission rate as approved by the PUC remains in effect until a new rate is approved by the PUC. Absent unusual circumstances, a TCOS rate case typically takes about six to eight months from the date of filing to the time the PUC issues a final order.

Pursuant to these PUC approved TCOS rate cases, TSPs charge DSPs for transmitted electric power through the transmission grid in the ERCOT region.

The second way in which a TSP may change its transmission rates is through an interim capital additions update process with the PUC. A TSP may update its transmission rates as often as annually to reflect changes in invested capital and taxes, but a TSP may not use this mechanism to update its operating and maintenance expenses or its cost of capital. This update process is intended to be essentially administrative and should take no longer than about two to three months. All of a TSP's expenses and capital additions will still be reviewed at its next TCOS rate case, and at such time the TSP can be ordered by the PUC to refund rates collected as a result of such updates if the PUC finds that the cost of the capital additions was unreasonable. If not otherwise filed, the PUC may prescribe a schedule for a TSP to file a TCOS rate case in order to examine costs associated with such interim filings.

Distribution Service Providers. As noted above, the DSPs provide electric distribution services through the operation of power lines carrying electricity below 60,000 volts, i.e., distributing electric power from TSP facilities to the retail, commercial and industrial consumer of electric power. DSPs, often referred to as "wires companies," are the entities which own retail electric distribution grids that take power from the electric transformer substations where power is stepped down from large voltages of 60,000 volts or above to voltages of below 60,000 volts and then distribute such electric power. The areas within ERCOT are served by various DSPs pursuant to service areas designated by PUC regulated CCNs. A DSP may not operate within an area without a CCN. While there are some dual or triple certificated areas within ERCOT, most areas within ERCOT are singularly certificated with only one DSP holding a CCN for such areas. Pursuant to PUC requirements, a DSP must construct, own, operate and maintain its electric distribution facilities, including its electric lines, meters, transformers and other equipment used in the delivery of electric power and energy, in accordance with good utility practice for the delivery of electric power and energy to retail electric customers located within the DSPs service territory and served by REPs.

The following table lists the major DSPs operating within the ERCOT electric transmission area.

ERCOT DISTRIBUTION SERVICE PROVIDERS	
<u>Load by DSP</u>	
TXU Electric Delivery Services Company	37%
CenterPoint Energy Houston Electric, LLC	26
AEP	9
Other DSPs	8
City Public Service of San Antonio	7
LCRA ⁽¹⁾	5
Austin Energy	4
Brazos Electric Power Coop ⁽¹⁾	<u>4</u>
	100%

⁽¹⁾ Represents the aggregated DSP load served; neither LCRA nor Brazos Electric Power Coop are DSPs.

In order for a DSP, as a regulated entity by the PUC, to establish its distribution charges, the DSP must file a tariff for retail delivery service with the PUC. All charges associated with the delivery of electric power to retail customers, including charges for both the distribution of electricity and for the transmission of electricity, must be authorized by the PUC pursuant to the tariff for retail delivery service. Each IOU affiliated DSP is required to file a distribution service rate case in the same fashion as TSPs as described above under "Rates Charged by TSPs". The charges associated with the delivery of electric power to retail customers, including charges for both the distribution of electricity and for the transmission of electricity, will be charged by the DSPs pursuant to the tariff for retail delivery service to the REPs utilizing the distribution services of the particular DSPs.

Municipal Utilities and Electric Coops providing distribution services are not required to file a tariff with the PUC to establish their rates for distribution service.

Retail Electric Providers. REPs serve as the billing entities for the end use retail customers in those IOU areas where customer choice is available to retail electric customers. In areas served by Municipal Utilities and Electric Coops that have opened to retail competition, a customer has the option to (i) receive a single bill for electric power and transmission and distribution charges from the Municipal Utility or the Electric Coop or (ii) receive separate bills from the REP and the Municipal Utility or the Electric Coop. Customer choice requires the end use customer to choose its REP. REPs separately contract with power generation companies to receive power and bill the retail electric customers for the cost of their power plus the associated distribution and transmission charges in one consolidated bill. The REP pays the DSP for the distribution and transmission charges associated with serving its retail customers that are within the particular DSP's service area. Currently, no Municipal Utilities have "opted in" or chosen to open their service territory to retail competition. One Electric Coop, Nueces Electric Coop., has opted in to retail competition, completing the process in August, 2005.

REPs must be certified by the PUC before they can participate in the retail electric market. As a requirement of obtaining and maintaining this certification, the PUC requires that all REPs meet certain financial resource standards. The PUC has made the policy decision to facilitate customer choice by providing standards that will attract REPs in order to increase the number of available REPs from which retail electric customers may choose. As a requirement for certification by the PUC, an REP or its parent corporation or controlling shareholder providing a guaranty to the REP must demonstrate and maintain either: (i) a minimum investment grade rating of "BBB-" by Standard & Poor's Ratings Group, "Baa3" for Moody's Investor Service, or their equivalent, including Fitch Ratings for financial institutions and Best for insurance companies, based on the REPs own credit rating, a bond, a guaranty or corporate commitment; (ii) assets in excess of liabilities by at least \$50,000,000 on its most recent balance sheet; or (iii) unused cash resources of at least \$100,000, which will allow the REP to incur in the State up to \$250,000 in monthly billings from Transmission/Distribution Utilities or in the event of higher monthly billings, the same ratio of unused cash resources to monthly billing charges to Transmission/Distribution Utilities. Transmission/Distribution Utilities may not impose any additional or separate credit conditions on an REP unless the REP has defaulted on a payment to the Transmission/Distribution Utility as discussed below. However, each of the major IOUs currently operating in ERCOT have affiliated REPs, and these REPs are significant participants in the retail electric market within ERCOT. However, no assurances can be given as to the credit quality of any of the REPs beyond the minimum requirements set forth by the PUC for certification of REPs.

As a requirement for certification of an REP that, together with any affiliates, serves one million or more residential customers in Texas by the PUC, an REP or its parent corporation or controlling shareholder providing a guaranty to the REP, including the security by a bond, guaranty, or corporate commitment of an affiliate or another entity, must demonstrate and maintain either: (i) a minimum investment grade rating of "BBB" by Standard & Poor's Ratings Group, "Baa2" for Moody's Investor Service, or their equivalent, including Fitch Ratings for financial institutions and Best for insurance companies, based on the REPs own credit rating, a bond, a guaranty or corporate commitment of an affiliate or another entity; (ii) assets in excess of liabilities in an amount equal to 300% of the total monthly amounts it is billed by Transmission/Distribution Utilities in the State; or (iii) unused cash resources in an amount equal to 100% of the total monthly amount it is billed by Transmission/Distribution Utilities in the State. The REPs serving one million or more residential customers must provide this information to the PUC on a quarterly basis. The REPs serving one million or more residential customers that do not meet these requirements are subject to review by the PUC.

Payment of Transmission Revenues

Payment of TSPs by the DSPs. The TSPs, including the Corporation, charge DSPs a monthly transmission service charge equal to the product of the respective TSP's transmission rate approved by the PUC and the particular DSP's share of the average coincident peak load for all of ERCOT for June, July, August and September of the previous year (the "4-Month Peak"). Pursuant to PUC rules, within a reasonable time after the first day of each month, TSPs shall issue billing invoices to the DSPs responsible for the movement of power within or from the ERCOT transmission grid. Unless the parties agree otherwise, such invoices must be paid so that the TSP receives the funds by the 35th calendar day after the issuance of the invoice. If a DSP fails to make this payment in the allotted time and such failure is not corrected within 30 calendar days after the TSP notifies the DSP of such failure, the DSP shall be considered to be in default. However, in the event of a billing dispute, the DSP will not be considered to be in default as long as the DSP continues to make all payments not in default and pays into an independent escrow account the portion of the invoice that is in dispute pending the resolution of such dispute. The PUC rules contain no provision that would excuse a DSP from its payment obligation to the TSP in the event that the DSP does not receive its payment from an REP as discussed below in "*Payment of the DSPs by the REPs.*"

If the PUC determines that the DSP is in default, the DSP must pay the particular TSP two times the amount of the payment that the DSP failed to pay, in addition to any other remedy ordered by the PUC. If a DSP is in default, the particular TSP may, upon notice to the PUC and the DSP, initiate a proceeding with the PUC to terminate service to the DSP. Disputes arising in connection with the termination or the proposed termination of service must be referred to the alternate dispute resolution process as required by the PUC's rules.

In order to determine whether a DSP has the ability to meet its obligations related to receiving electric transmission services, a TSP may require a reasonable credit review procedure in accordance with standard commercial practices. Such creditworthiness standards must be applied to all DSPs on a non-discriminatory basis. TSPs are also authorized under the PUC's rules to require DSPs to provide and maintain an unconditional and

irrevocable letter of credit in a reasonable amount as security during the term of service that reasonably protects the TSP against the risk of non-payment. However, if a DSP is creditworthy, then no letter of credit or alternative form of security may be required under the PUC's rules. The Corporation and LCRA believe that no TSP, including the Corporation, has undertaken to require any credit review of any DSP.

Payment of the DSPs by the REPs. Pursuant to the rates established in the tariff for retail delivery service approved by the PUC, a DSP bills an REP whose retail customers receive their electric power from the distribution facilities of the DSP for the cost of the delivery of that power, including the transmission and distribution costs. DSPs send monthly billing invoices to REPs. Payment for all electric delivery charges invoiced to the DSP is due 35 calendar days later unless such day falls on a weekend or bank holiday, in which case the due date is the next business day. The tariff for retail delivery service specifically provides that payments by the REP are due without regard to whether the REP has received payment from its retail customers. Any payments not received by the DSP by the due date are considered delinquent and subject to a one-time late fee of 5% of the delinquent balance. The DSP must notify the REP of such delinquency. The REP has a ten calendar day grace period to pay the delinquent balance before the REP is considered to be in default. If at the end of the grace period the only remaining amount to be paid by the REP is the 5% penalty, the REP will not be considered to be in default for an additional 30 calendar days if such penalty is not paid.

If the REP disputes all or a portion of a billing invoice, the REP may refuse to pay only the disputed amount, but must provide a written notice to the DSP including an explanation of the disputed portion of the invoice, the basis of the dispute and a proposed resolution. The DSP must then investigate the dispute and report the results to the REP within ten business days. In the event that the REP and the DSP are unable to resolve the dispute within 30 calendar days, the dispute may be referred to mediation or submitted to binding arbitration by mutual agreement of the REP and the DSP. In the event that binding arbitration is not chosen and a resolution is not obtained within 30 calendar days after the initial dispute notice provided by the REP, the DSP may file a complaint with the PUC.

Additionally, in the event of nonpayment by an REP where the REP has not disputed the charged amount as described in the previous paragraph, the DSP may present the REP with a written notice of complaint. The REP must then respond by the following 10th business day. In the event that the REP and the DSP are unable to resolve the dispute within 30 calendar days, the dispute may be referred to mediation or submitted to binding arbitration by mutual agreement of the REP and the DSP. In the event that binding arbitration is not chosen and a resolution is not obtained within 30 calendar days after the initial complaint notice provided by the DSP, the DSP may file a complaint with the PUC. Therefore, in the event of nonpayment by an REP and assuming the DSP provides its notices in a timely fashion, the DSP has the right to have the matter brought before the PUC after 40 calendar days from when the payment was due.

In the event a complaint is filed with the PUC, the PUC may suspend an REP's business operations in the State or revoke such operations. The PUC rules provide that the following is a nonexclusive list of significant violations by a REP: failure to maintain the minimum required financial resources; bankruptcy, insolvency or the inability to meet financial obligations on a reasonable and timely basis; failure to remit payment for invoiced charges to a Transmission/Distribution Utility pursuant to the statewide tariff and certain other specified violations. In the event that the PUC suspends or revokes the operations of an REP, the retail electric customers may choose a new REP or the retail electric provider of last resort will assume the responsibilities of the original REP. A successor REP is not obligated to pay the delinquent balance of another REP, but the defaulting REP is not relieved from its obligation to pay the previously invoiced charges and late fees. Moreover, previously invoiced charges that are subsequently collected by a provider of last resort that succeeds a defaulting REP must be remitted to the Transmission/Distribution Utility that provided the transmission or distribution service to such REP. Only after all such delinquent charges are paid may any funds be released to the defaulting REP.

The Corporation is aware of five REPs (of at least 130 REPs within ERCOT) that have defaulted in 2008.

Transmission Constraints

Although a significant amount of new transmission facilities have been completed and upgraded in the State since 1999, significant transmission constraints limit the deliverability of some generation resources in the State, especially wind power generated in west Texas.

A transmission constraint is a physical limitation in the transmission system that prevents the reliable delivery of electricity, and can prevent more economic generation resources from being utilized. Transmission constraints prevent the most economic dispatch of generation resources and result in a need to continue operating less efficient generating units. Such constraints potentially create significant generation market inefficiencies.

Congestion is relieved through rearranging or "re-dispatching" generation such that the flow of electricity on the grid is altered, and the constraining line is no longer in danger of being overloaded. ERCOT orders generating units to lower or increase their output in order to relieve congestion, and these generating units receive payments to do so from other generation market participants.

In dealing with transmission congestion, ERCOT uses a zonal congestion management system. In the zonal system, the transmission elements that are most likely to limit the free flow of electricity are identified as "commercially significant constraints." The transmission grid is then divided into congestion zones such that each of the generators and loads within a zone has a similar effect on the commercially significant constraints between the zones. In this zonal system, congestion not only occurs between zones ("zonal congestion"), but also within a zone ("local congestion"). As reported by ERCOT, for calendar year 2006, commercially significant constraint congestion costs were about \$52 million and local congestion costs were about \$183 million. For the same period, ERCOT reported reliability must-run costs of about \$65 million.

New transmission capacity increases the reliability of service and allows new generation to be fully integrated into the transmission grid, thereby providing for additional competition and reduced electricity prices. While increased transmission investment increases the cost of the delivery rates of the Transmission/Distribution Utilities, it also reduces congestion costs and the operation of less efficient generation units.

ERCOT also identifies transmission projects that are needed to reduce the magnitude of transmission constraints or to improve system reliability. The ERCOT region is an area where transmission facilities are being actively planned and built. Since ERCOT began conducting regional transmission planning, the PUC has licensed and utilities have built over 900 right-of-way miles of transmission facilities of various voltages in ERCOT. In addition, there has been numerous other transmission projects built that have not required a PUC license.

OTHER REGULATORY MATTERS

The Energy Policy Act of 1992

The federal Energy Policy Act of 1992 (the "Energy Act"), greatly expands the authority of the United States Federal Energy Regulatory Commission (the "FERC") to order utilities, including utilities within ERCOT, to provide transmission service for other utilities, qualifying facilities, and independent power producers. The FERC also has authority to determine the prices that may be charged for transmission, but has generally deferred to the PUC electric transmission open access rules for access and pricing within ERCOT.

Retail Wheeling

The authority to order retail wheeling, which allows a retail customer to be located in one utility's service area and to obtain power from another utility or non-utility source, is specifically excluded from the enhanced authority granted to the FERC under the Energy Act. However, while the States may have authority to determine whether retail wheeling will be permitted, FERC has determined that it has jurisdiction over the rates, terms and conditions of the transmission portion of retail wheeling.

FERC Final and Proposed Rules and Rulemakings in Federal Regulation of Electric Utilities

To establish foundations necessary to develop a competitive wholesale electricity market and effectuate the transmission access provisions of the Energy Policy Act, on April 24, 1996, FERC issued two final rules ("FERC Rules") on non-discriminatory open access transmission services by public utilities and stranded cost recovery rules. The first of the FERC Final Rules, Order No. 888, requires all public utilities that own, control or operate facilities used for transmitting electric energy in interstate commerce to (i) file open-access, non-discriminatory transmission tariffs containing, at a minimum, the non-price terms and conditions set forth in the order and (ii) functionally unbundle wholesale power services by (1) applying unified transmission tariffs system to all customers, (2) providing

separate rate systems for wholesale generation, transmission and ancillary services and (3) relying on the same electronic information dissemination network that its transmission customers rely on in selling and purchasing power. The second final rule, Order No. 889, requires all public utilities to establish or participate in an Open Access Same-Time Information System (OASIS) that meets certain specifications, and comply with standards of conduct designed to prevent employees of a public utility (or any employees of its affiliates) engaged in wholesale power marketing functions from obtaining preferential access to pertinent transmission system information.

The FERC stated that its overall objective is to ensure that all participants in wholesale electricity markets have non-discriminatory open access to transmission service, including network transmission service and ancillary services. The FERC also indicated that it intends to apply the principles set forth in the FERC Rules to the maximum extent to municipal and other non-FERC regulated utilities, both in deciding cases brought under the Federal Power Act and by requiring such utilities to agree to provide open access transmission service as a condition to securing transmission service from jurisdictional investor-owned utilities under open access tariffs.

In addition, on December 20, 1999 the FERC adopted rules to establish Regional Transmission Organizations ("RTOs"). The rules contemplate RTOs as voluntary participation associations of power transmission owning entities, comprising public and non-public utility entities, which would more efficiently address operational and reliability issues confronting the industry in particular by improving grid reliability, increasing efficiencies in transmission grid management, preventing discriminatory practices and improving market performance. On July 11, 2001, FERC directed the formation of four large RTOs, that excluded ERCOT.

Although the FERC Rules do not directly regulate municipally owned and other non-FERC-regulated utilities such as LCRA, the FERC Rules have a significant impact on such utilities' operations. The FERC Rules have significantly changed the competitive climate in which the non-FERC regulated utilities operate, giving their customers much greater access to alternative sources of electric transmission services. The rules require them to provide open access transmission service conforming to the requirements for investor-owned utilities whenever they are properly requested to do so under the Energy Policy Act or as a condition of taking transmission service from an investor owned utility. In certain circumstances, the non-FERC-regulated utilities are required to pay compensation to their present suppliers of wholesale power and energy for stranded costs that may arise when the non-FERC-regulated utilities exercise their option to switch to an alternative supplier of electricity.

LCRA and the Corporation submit various reports to the FERC and substantially conform to the FERC Uniform System of Accounts in maintaining their books of account. Historically, electric utilities operating in the State have not had any interstate connections other than in certain emergency situations and hence IOUs', LCRA's and the Corporation's electric generation, transmission and transformation facilities have not been subject to the FERC regulatory or licensing requirements on the basis of such interstate connections. Over the past several years, various efforts have been made to provide some interstate connections. These efforts have resulted in protracted judicial and administrative proceedings involving ERCOT members. The FERC has issued orders, which, among other things, permit the ERCOT members to avoid federal regulation of rates as the result of the ordered interconnections with another interstate connected utility.

On July 31, 2002, FERC issued its Notice of Proposed Rulemaking ("NOPR") in Docket No. RM01-12-000, *Remedying Undue Discrimination Through Open Access Transmission Service and Standard Electricity Market Design*. The NOPR, has been proposed to correct the perceived inadequacies of Order Nos. 888, 889 and 2000. According to FERC, additional mandatory measures are required to address discriminatory practices and preferences that continue to be exercised by incumbent transmission owners that frustrate the open-access transmission goals outlined in Order Nos. 888, 889 and 2000. The NOPR seeks to impose standard market design principles, including a new pro forma transmission tariff to replace Order 888's pro forma Open Access Transmission Tariff. At the current time, the Corporation cannot predict with accuracy whether FERC will amend its proposed rule based on comments to the NOPR or whether Congress will require FERC to include or exclude various regulatory provisions. Likewise, the Corporation cannot predict at the current time whether Congress or FERC will attempt to impose directly on ERCOT any provision of the NOPR. As currently written, the NOPR does not purport to directly regulate transmission access within ERCOT.

Proposed Federal Legislation

Many bills have been introduced in the United States House of Representatives and the United States Senate to deregulate the electric utility industry on the federal or state level. Many of the bills provide for open competition in the furnishing of electricity to all retail customers (i.e., retail wheeling). In addition, various bills have been introduced that would impact the issuance of tax-exempt bonds for electric transmission facilities. No prediction can be made as to whether these bills or any future proposed federal bills will become law or, if they become law, what their final form or effect would be.

Environmental Regulation

Electric utilities are subject to numerous environmental regulations administered at the federal, state and local level. The Corporation, however, does not believe that present environmental regulations have any significant impact on the Corporation's operation of its expanding electric transmission and transformation system. The Corporation is aware of the ongoing research effort focusing on biological effects of electric and magnetic fields ("EMF") and the scientific endeavor to determine if such effects have any implications to human health. At this time, it is a matter of scientific uncertainty as to whether human exposure to EMF poses a significant health risk. For the last several years, LCRA has been committed to an active EMF program and the LCRA Board has adopted an EMF policy that includes maintaining an EMF task force to keep abreast of relevant scientific, regulatory and legal developments, media coverage, and public concerns; active participation in EMF task forces at state and national levels; an EMF communications program for LCRA employees, customers and the public, providing information as new scientific developments occur; and support of ongoing EMF health effects research through appropriate financial contributions. The Corporation intends to continue such policies. The Corporation also has an active program to ensure compliance with the Endangered Species Act, and manage risk associated with threatened and endangered species and their habitat. Habitat on transmission rights-of-way and within project areas is mapped and impacts to protected species are avoided, minimized or mitigated.

Reliability Compliance

The federal Energy Policy Act of 2005 (the "2005 Energy Act") significantly changed the electric regulatory climate in North America. The 2005 Energy Act requires all electric utilities in the United States to comply with reliability standards promulgated and enforced by NERC, under the supervision of FERC. Such mandatory and enforceable reliability standards include the ability to assess civil penalties for violations of such standards. The 2005 Energy Act also allows NERC to delegate enforcement authority to a regional entity, subject to FERC approval, and NERC has designated the Texas Regional Entity (a division of ERCOT) as the regional enforcement entity within ERCOT.

The Corporation and LCRA are committed to the establishment and maintenance of a program to comply with and exceed the NERC reliability standards. This will require an ongoing effort to monitor the reliability standards, develop procedures to provide for implementation and install processes to assure continued compliance. To accomplish this, a transmission NERC compliance manager has been appointed and a compliance organization within LCRA's Transmission Services Business Unit has been established. In addition, an oversight group composed of staff of LCRA, including certain members of executive management, will provide management guidance and support to the compliance efforts. The Corporation and LCRA believe they are in material compliance with current NERC reliability standards.

TRANSMISSION CONTRACT REVENUE FINANCING PROGRAM

LCRA's Transmission Contract Revenue Financing Program, established by the Controlling Resolution, is a comprehensive program designed to accommodate the issuance or incurrence of Transmission Contract Debt, for the benefit of The Corporation, that is secured by a lien on and pledge of the Installment Payments and the relevant funds created in the Controlling Resolution and the applicable Supplement. In connection with the issuance and delivery of Transmission Contract Debt, LCRA and The Corporation have entered into an amended and restated Transmission Contract Revenue Debt Installment Payment Agreement, dated as of March 1, 2003 (the "Installment Payment Agreement"). The Installment Payments required to be made by The Corporation to LCRA pursuant to the Installment Payment Agreement are designed to be sufficient to enable LCRA to pay, among other requirements, when due and payable, the principal of, premium, if any, and interest on all Outstanding Transmission Contract Debt. Certain debt

issued by The Corporation, however, may also be secured by the Net Revenues of The Corporation on parity with the Installment Payments, however, subordinate to the first lien on the Gross Revenues of The Corporation securing Purchase Price Payments under the Initial Contractual Commitment.

As used in the preceding paragraph, "Net Revenues" means Gross Revenues with respect to any period, less any Purchase Price Payments due to LCRA and less the Operating and Maintenance Expenses during such period. "Gross Revenues" means all revenues, income, tolls, rents, fees, charges and receipts received by The Corporation from the operation and ownership of its properties, facilities and operations and all rights to receive the same, whether in the form of accounts receivable, contract rights, or other rights, and the proceeds thereof, as determined by Accounting Principles to constitute revenues of The Corporation (excluding (i) customers' deposits while retained as such, (ii) contributions in aid of construction, (iii) any Moneys obtained pursuant to drawings on a letter of credit, line of credit, bond insurance policy or similar financial arrangement securing the payment, and used to pay principal of, or premium and interest on, Transmission Contract Debt, and (iv) any insurance or condemnation proceeds meeting the requirements of the Installment Payment Agreement or the Initial Contractual Commitment), including earnings and income derived from the investment of Moneys in any funds or accounts created and maintained by The Corporation. "Operating and Maintenance Expenses" means all reasonable and necessary costs and expenses incurred in the operation and maintenance of The Corporation according to Accounting Principles, but excluding (a) depreciation and (b) amortization of property values or losses.

Transmission Contract Debt is secured by and payable solely from a lien on and pledge of the Installment Payments and certain funds held by LCRA under the Controlling Resolution and the applicable Supplement. The Corporation is obligated under the Installment Payment Agreement to make Installment Payments to LCRA from the Net Revenues of The Corporation in amounts sufficient to make all required payments of principal of, premium, if any, and interest on Transmission Contract Debt. The Corporation's obligation to make Installment Payments to LCRA under the Installment Payment Agreement from the Net Revenues is secured by a pledge of and lien on Net Revenues in favor of LCRA and is subject to The Corporation's obligation to make payment from Gross Revenues of Purchase Price Payments under the Initial Contractual Commitment and Operating and Maintenance Expenses of The Corporation. The Corporation's obligation to make Purchase Price Payments to LCRA under the Initial Contractual Commitment is secured by and payable from a first lien and pledge of all Gross Revenues in favor of LCRA. Other than the Installment Payments and the relevant funds created in the Controlling Resolution and the applicable Supplement, bondowners of Transmission Contract Debt do not have a lien on any other moneys of either LCRA or The Corporation, including the Net Revenues or the Gross Revenues of The Corporation. See "THE CORPORATION - Initial Contractual Commitment."

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CAPITAL CHARGE REQUIREMENTS

The table below illustrates the annual Capital Charges required to be paid by the Corporation that include the annual payments due to LCRA pursuant to the Initial Contractual Commitment payable from and secured by a first lien on and pledge of the Gross Revenues of the Corporation and Installment Payments under the Installment Payment Agreement.

Fiscal Year Ending June 30,	Requirements of the Initial Contractual Commitment	Debt Service Requirements of Outstanding Transmission Contract Debt ⁽¹⁾	Total Capital Charges ⁽¹⁾
2009	\$ 28,423,550	\$ 62,630,027	\$ 91,053,577
2010	28,422,850	86,535,930	114,958,780
2011	28,421,900	87,163,380	115,585,280
2012	28,410,650	87,162,155	115,572,805
2013	28,406,899	87,162,211	115,569,110
2014	28,405,150	87,162,518	115,567,668
2015	28,400,149	87,165,211	115,565,360
2016	28,391,900	87,161,655	115,553,555
2017	25,800,769	84,577,674	110,378,443
2018	16,391,423	82,065,349	98,456,772
2019	29,252,807	79,622,774	108,875,581
2020	26,746,980	77,247,699	103,994,679
2021	4,418,675	74,933,794	79,352,469
2022	4,412,675	64,731,045	69,143,720
2023	4,412,250	62,548,551	66,960,801
2024	4,420,250	60,426,283	64,846,533
2025	4,422,500	58,374,583	62,797,083
2026	4,419,000	56,395,439	60,814,439
2027	4,424,750	54,471,133	58,895,883
2028	4,419,000	52,610,233	57,029,233
2029	8,927,000	50,821,695	59,748,695
2030	10,577,750	49,091,795	59,669,545
2031	10,247,500	47,578,745	57,826,245
2032	4,730,250	46,090,945	50,821,195
2033	-	44,987,708	44,987,708
2034	-	43,658,220	43,658,220
2035	-	42,493,545	42,493,545
2036	-	22,133,505	22,133,505
TOTALS	\$395,306,627	\$1,827,003,801	\$2,222,310,428

(1) Reflects mandatory sinking fund redemption of certain term bonds. The debt service requirements also include \$82 million of tax exempt commercial paper notes bearing interest at an assumed rate of 3.5%. All commercial paper is amortized assuming level debt service payments through an assumed maturity date of May 15, 2021.

LITIGATION

There are various lawsuits in which the Corporation is involved. The Corporation's management, including its General Counsel, estimates that the potential claims against the Corporation not covered by insurance resulting from such litigation would not materially affect the Corporation's financial condition or its obligations with respect to Transmission Contract Debt or its other outstanding obligations, including payments to LCRA under the Initial Contractual Commitment.

APPENDIX C DEFINITIONS

As used in this Appendix C, the following terms shall have the meanings set forth below, unless the context specifically indicates otherwise:

"4 Month Peak" - The average of a particular DSP's coincident peak load for June, July, August and September of the previous year.

"Acquisition Bonds" - All bonds, notes, or other obligations hereafter issued by LCRA, whether in one or more series or issues, or portions thereof, whether constituting LCRA Additional Indebtedness or debt subordinate thereto, pursuant to the LCRA Master Resolution, which are issued to pay the cost of the Corporation's acquisition and/or construction of Additional Transmission Facilities or to refund all or a portion of such Acquisition Bonds attributable to any Additional Transmission Facilities or to refund any such refunding bonds. It is recognized that Acquisition Bonds may consist of a portion of a series of LCRA Additional Indebtedness, the other portions of such series are being issued for other purposes of LCRA not related to the Corporation.

"Additional Allocated LCRA Plant Purchase Price Payments" - Any additional payments, pursuant to the Initial Contractual Commitment, relating to any additional LCRA general plant facilities and equipment acquired and/or constructed subsequent to the delivery of the Initial Contractual Commitment and authorized pursuant to a Contract Supplement.

"Additional Purchase Price Payments" - Any additional purchase price payments, pursuant to the Initial Contractual Commitment, relating to any Additional Transmission Facilities or a refunding of LCRA Outstanding Indebtedness allocated to the Corporation or Acquisition Bonds authorized pursuant to a Contract Supplement, with such Additional Purchase Price Payments attributable to a series of Acquisition Bonds.

"Additional Transmission Contract Debt" - Transmission Contract Debt which LCRA reserves the right to issue or enter into, as the case may be, in the future under the terms and conditions provided in the Controlling Resolution and which obligations are equally and ratably secured solely by a first lien on and pledge of the Installment Payments on parity with the Transmission Contract Debt for the purpose of (i) the acquisition, construction and improvement of certain electric transmission and transformation facilities as described in the Installment Payment Agreement, (ii) the refinancing and refunding of any debt related to any electric transmission and/or transformation facilities being acquired by, or on behalf of, the Corporation, (iii) the refunding of any Transmission Contract Debt or any other debt payable from Installment Payments, and (iv) any other purpose authorized by State law.

"Additional Transmission Facilities" - Any additional electric transmission and/or transformation properties, facilities or assets to be acquired and/or constructed for or by the Corporation pursuant to a Contract Supplement.

"AEP" - American Electric Power Services Company.

"CCN" - A certificate of convenience and necessity issued by the PUC.

"Capital Charges" - Any Purchase Price Payments under the Initial Contractual Commitment and debt service for all debt obligations of the Corporation, including Transmission Contract Debt.

"Contract Supplement" - A contract supplemental to, and authorized and executed pursuant to the terms of, the Initial Contractual Commitment (i) providing for Additional Transmission Facilities for the Corporation or the refunding of any LCRA Outstanding Indebtedness allocated to the Corporation or Acquisition Bonds and for the Corporation's payment of Additional Purchase Price Payments to LCRA for such purposes, (ii) providing for the

Corporation's payment of Additional Allocated LCRA Plant Purchase Price Payments to LCRA as provided in the Initial Contractual Commitment, (iii) providing for the Corporation's payment of Guarantee Reimbursement Payments to LCRA as provided in the Initial Contractual Commitment and/or to reflect prepayments made pursuant to the Initial Contractual Commitment.

"Controlling Resolution" - The amended and restated resolution adopted by the LCRA Board on February 19, 2003 and amended on January 19, 2005 entitled a "Controlling Resolution Establishing the Lower Colorado River Authority Transmission Contract Revenue Financing Program and Authorizing the Transmission Contract Revenue Debt Installment Payment Agreement with the LCRA Transmission Services Corporation".

"Corporation" - The LCRA Transmission Services Corporation, an LCRA affiliated, nonstock, nonprofit corporation organized under the laws of the State, including Chapter 152, Texas Water Code, as amended.

"Corporation Board" - the Board of Directors of the Corporation.

"Deed of Trust, Mortgage and Security Agreement" - The Deed of Trust, Mortgage and Security Agreement required by the Initial Contractual Commitment and the Installment Payment Agreement which shall be effective as of the effective date of the transfer of the Transferred Transmission Assets. Enforcement of the rights under the Deed of Trust, Mortgage and Security Agreement are subject to the provisions of the Initial Contractual Commitment.

"DSP" - A provider of electric distribution services through the operation of power lines carrying electricity below 60,000 volts to distribute electric power from TSP facilities to the affiliate retail, commercial and industrial consumers of electric power in the ERCOT region.

"Electric Coop" - Electric Cooperatives.

"ERCOT" - The Electric Reliability Council of Texas.

"Extraordinary LCRA Optional Purchase Price Payments" - Any additional payment due to LCRA from the Corporation as determined by the LCRA Board pursuant to the Initial Contractual Commitment annually in an amount to be determined by the LCRA Board but in no case in any year to exceed twenty-five percent (25%) of the aggregate total of Initial Facilities Purchase Price Payments, Additional Purchase Price Payments, Additional Allocated LCRA Plant Purchase Price Payments and Guarantee Reimbursement Payments paid by the Corporation under the Initial Contractual Commitment and any Contract Supplement in that Fiscal Year; provided, however, any such Extraordinary LCRA Optional Purchase Price Payment is limited to, and payable solely from, the Gross Revenues of the Corporation received in such Fiscal Year (i.e., excluding any retained revenue fund balance from prior Fiscal Years) after payment of (i) all Purchase Price Payments payable in the applicable Fiscal Year, (ii) all Operating and Maintenance Expenses of the Corporation payable in the applicable Fiscal Year, including any payments due to LCRA pursuant to any services agreement between LCRA and the Corporation, (iii) the annual debt service on any debt or other obligations (including any payments by the Corporation under a contract supporting any debt issued by LCRA or any other party on behalf of the Corporation) of the Corporation due in the applicable Fiscal Year and (iv) the amount of all payments required for any Capital Charge coverage ratios required by the financial policies of the Corporation and to otherwise accumulate the required funds in any debt service reserve fund related to any debt or other obligations of the Corporation or any other funds required by any agreement or the financial policies of the Corporation (which may be amended from time to time at the sole discretion of the Corporation) due in the applicable Fiscal Year.

"Fiscal Year" - The Corporation's fiscal year, which currently begins on July 1 of each year, as it may be changed from time to time with the prior written approval of LCRA.

"Government Obligations" - Means (a) direct, noncallable obligations of the United States of America, including obligations that are unconditionally guaranteed by the United States of America, (b) noncallable obligations of an agency or instrumentality of the United States of America, including obligations that are unconditionally guaranteed or insured by the agency or instrumentality and that are rated as to investment quality by a nationally recognized investment rating firm not less than AAA or its equivalent, and (c) noncallable obligations of a state or an agency or a county, municipality, or other political subdivision of a state that have been refunded and that are rated as to investment quality by a nationally recognized investment rating firm not less than AAA or its equivalent.

"Gross Revenues" or "Gross Revenues of the Corporation" - All revenues, income, tolls, rents, fees, charges and receipts received by the Corporation from the operation and ownership of its properties, facilities and operations and all rights to receive the same, whether in the form of accounts receivable, contract rights, or other rights, and the proceeds thereof, as determined by Accounting Principles to constitute revenues of the Corporation (excluding (i) customers' deposits while retained as such, (ii) contributions in aid of construction, (iii) any moneys obtained pursuant to drawings on a letter of credit, line of credit, bond insurance policy or similar financial arrangement securing the payment, and used to pay principal of, or premium and interest on, Transmission Contract Debt, and (iv) any insurance or condemnation proceeds meeting the requirements of the Installment Payment Agreement or the Initial Contractual Commitment), including earnings and income derived from the investment of moneys in any funds or accounts created and maintained by the Corporation.

"Guarantee Reimbursement Payments" - Any additional payments, pursuant to the Initial Contractual Commitment, relating to reimbursement to LCRA for amounts expended by LCRA in its performance under any LCRA Affiliate Guarantee (including the LCRA JDA Guarantee) and authorized pursuant to a Contract Supplement.

"Initial Contractual Commitment" - The Lower Colorado River Authority - LCRA Transmission Services Corporation Electric Transmission Facilities Contract, dated as of October 1, 2001, between LCRA and the Corporation, as amended, pursuant to which LCRA conveyed the Transferred Transmission Assets to the Corporation on January 1, 2002.

"Initial Facilities Purchase Price Payments" - Certain payments required to be made by the Corporation to LCRA under the Initial Contractual Commitment in return for the conveyance of the Transferred Transmission Assets in the amounts and at the times necessary to allow LCRA to pay its annual LCRA debt service requirements on LCRA debt, if any, relating to the LCRA Outstanding Indebtedness at the time of the transfer of the Transferred Transmission Assets and to pay all expenses and costs of LCRA, including overhead, related to the activities of LCRA under such Contractual Commitment. Initial Facilities Purchase Price Payments by the Corporation to LCRA under the Initial Contractual Commitment are required to be paid as the first expenses paid from the Gross Revenues of the Corporation.

"Installment Payment Agreement" - The amended and restated Transmission Contract Revenue Debt Installment Payment Agreement, dated as of March 1, 2003, between LCRA and the Corporation relating to any Transmission Contract Debt.

"IOU" - An investor-owned electric utility.

"ISO" - The independent system operator of ERCOT that coordinates the operation of the ERCOT transmission grid to ensure its reliability.

"JDA" - Joint Development Agreement, effective July 14, 2001 and as amended in September 2003, between the Corporation and AEP pursuant to which the Corporation will own, finance and operate certain PUC or ERCOT approved "in-scope" transmission projects located outside LCRA's traditional electric service area.

"LCRA Additional Indebtedness" - Debt issued by LCRA after the delivery of the Initial Contractual Commitment, including any Acquisition Bonds.

"LCRA Affiliate Guarantee" - Any guarantee of LCRA guaranteeing, or any other LCRA credit agreement supporting, any public security, obligation or contract of the Corporation as may be permitted by State law.

"LCRA Board" - The Board of Directors of LCRA.

"LCRA JDA Guarantee" - The Lower Colorado River Authority Guarantee of LCRA Transmission Services Corporation - American Electric Power Services Company Joint Development Agreement.

"LCRA Master Resolution" - Resolution No. 99-165b, being the "Master Resolution Establishing the Lower Colorado River Authority Revenue Financing Program," adopted by the LCRA Board on September 22, 1999, as may be amended or supplemented from time to time.

"LCRA Officer" - The General Manager of LCRA or the Chief Financial Officer of LCRA.

"LCRA Outstanding Indebtedness" - The outstanding debt of LCRA at the time of the delivery of the Initial Contractual Commitment.

"LCRA Outstanding Tax-Exempt Indebtedness" - The outstanding tax exempt debt of LCRA at the time of the delivery of the Initial Contractual Commitment.

"LCRA Statutory Rate Covenant" - The statutory rate covenant set forth in the LCRA Act running to the benefit of the Owners of the LCRA Outstanding Indebtedness and the LCRA Additional Indebtedness but having application to the Corporation's Initial Purchase Price Payments.

"LCRA's Pledged Revenues" - All amounts received by LCRA pursuant to Contractual Commitments and all lawfully available funds of LCRA, including (i) all revenues, according to Accounting Principles, received or derived by LCRA, and (ii) all fund balances attributable to such revenues. LCRA's Pledged Revenues shall not include (i) customer's deposits while retained as such, (ii) contributions in aid of construction, (iii) earnings on proceeds (or amounts deemed to be proceeds pursuant to the Code), of debt to the extent that LCRA is required to rebate such earnings to the United States of America pursuant to the Code, (iv) any investment earnings in any rebate fund established with respect to any debt, (v) any moneys obtained pursuant to drawings on a letter of credit, line of credit, bond insurance policy or similar financial arrangement securing the payment, and used to pay principal of, or premium and interest on, any debt, (vi) any proceeds obtained pursuant to the remarketing of any debt of LCRA, (vii) income derived from the operation or ownership of Separate System Projects or received pursuant to a contract entered into with respect to Contract Revenue Bonds, (viii) noncash accounting adjustments relating to an accounting rule such as GASB Statement No. 31 and FASB Statement No. 133, (ix) income and fund balances of any entity whose financial statements are required by Accounting Principles to be consolidated with those of LCRA and (x) and sales taxes collected on behalf of the State.

"Municipal Utility" - An electric utility operated by a municipality in the ERCOT region of the State.

"Net Revenues or Net Revenues of the Corporation" - Gross Revenues with respect to any period, less any Purchase Price Payments due to LCRA and less the Operating and Maintenance Expenses during such period.

"New Affiliate" - A new LCRA affiliated nonprofit corporation under Chapter 152, Texas Water Code, as amended, other than the Corporation, which assume the rights and obligations of the Corporation in certain circumstances.

"Operating and Maintenance Expenses" - All reasonable and necessary costs and expenses incurred in the operation and maintenance of the Corporation according to Accounting Principles, but excluding (a) depreciation and (b) amortization of property values or losses.

"Prudent Utility Practice" - Any of the practices, methods, and acts, in the exercise of reasonable judgment, in the light of the facts, including but not limited to the practices, methods, and acts engaged in or approved by a significant portion of the public utility industry prior thereto, known at the time the decision was made, that would have been expected to accomplish the desired result at the lowest reasonable cost consistent with reliability, safety, and expedition. It is recognized that Prudent Utility Practice is not intended to be limited to the optimum practice, method, or act at the exclusion of all others, but rather is a spectrum of possible practices, methods, or acts which could have been expected to accomplish the desired result at the lowest reasonable cost consistent with reliability, safety, and expedition. In the case of any facility included in the Transmission Facilities which is owned in common with one or more other entities, the term "Prudent Utility Practice," as applied to such facility, shall have the meaning set forth in the agreement governing the operation of such facility.

"PUC" - The Public Utility Commission of Texas.

"Purchase Price Payments" - The Initial Facilities Purchase Price Payments, the Additional Purchase Price Payments, the Additional Allocated LCRA Plant Purchase Price Payments, the Rebate Requirement Purchase Price Payments and the Guarantee Reimbursement Payments. Purchase Price Payments do not include Extraordinary LCRA Optional Purchase Price Payments.

"Rebate Requirement Purchase Price Payments" - Any additional payments, pursuant to the Initial Contractual Commitment, relating to any payments reasonably determined by LCRA pursuant to be properly allocable to the Corporation in order to meet its rebate obligations to LCRA under the Code.

"REP" - A retail electric provider that serves as the billing entity for the end use retail customers in those areas where customer choice is available to retail electric customers.

"SB 7" - Senate Bill 7, enacted as Chapter 405, Acts of the 76th Legislature, Regular Session, 1999.

"Services Agreement" - The services agreement between LCRA and the Corporation pursuant to which LCRA personnel, including primarily those that are currently operating LCRA's Transmission Services Business Unit, will be responsible for performing all of the Corporation's activities.

"State" - The State of Texas.

"Supplement" - A resolution supplemental to, and authorized and executed pursuant to the terms of, the Controlling Resolution.

"TCOS" - Transmission cost of service.

"TSP" - An electric transmission service provider in the ERCOT region of the State.

"Transferred Transmission Assets" - Certain electric transmission and/or transformation assets, facilities and properties, including real property, easements, leases, contracts, etc., relating to LCRA's electric transmission and transformation businesses transferred and conveyed from LCRA to the Corporation pursuant to the Initial Contractual Commitment.

"Transmission Contract Debt" - All debt or similarly secured obligations, issued or incurred in accordance with the terms of the Controlling Resolution and a supplement, which are payable from and equally and ratably secured by a lien on and pledge of the Installment Payments.

"Transmission Contract Revenue Notes" - The "Lower Colorado River Authority Transmission Contract Revenue Commercial Paper Notes (LCRA Transmission Services Corporation Project), Tax-Exempt Series" issued by LCRA as Transmission Contract Debt on behalf of the Corporation.

"Transmission/Distribution Utility" - A new, separate transmission and distribution utility company required by SB 7 that may potentially provide electric transmission services and/or electric distribution services in the ERCOT region of the State.

"Transmission Facilities" - Collectively, the Transferred Transmission Assets and any Additional Transmission Facilities.

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APPENDIX D

**LCRA TRANSMISSION SERVICES CORPORATION
MANAGEMENT'S DISCUSSION AND ANALYSIS**

AND

**FINANCIAL STATEMENTS FOR THE FISCAL YEARS ENDED
JUNE 30, 2008 AND 2007**

With Independent Auditors' Report

LCRA Transmission Services Corporation Management's Discussion and Analysis Year Ended June 30, 2008

The LCRA Transmission Services Corporation (LCRA TSC), a component unit of the Lower Colorado River Authority (LCRA), began operations as a nonprofit corporation on Jan. 1, 2002, in conjunction with the transfer of LCRA's transmission and transformation assets to LCRA TSC pursuant to the terms of an Electric Transmission Facilities Contract (Contractual Commitment) dated Oct. 1, 2001.

Overview of the Financial Statements

In accordance with Governmental Accounting Standards Board (GASB) Statement No. 34, "Basic Financial Statements – Management's Discussion and Analysis – for State and Local Governments," LCRA TSC, a component unit of LCRA, is considered a special-purpose government engaged only in business type activities. GASB Statement No. 34 requires the following components in a governmental entity's annual report:

Management's Discussion and Analysis

The purpose is to provide an objective and easily readable analysis of the government's financial activities based on currently known facts, decisions or conditions.

Balance Sheets

Assets and liabilities of proprietary funds should be presented to distinguish between current and long-term assets and liabilities.

Statements of Revenues, Expenses and Changes in Net Equity

This statement provides the operating results broken into the various categories of operating revenues and expenses, nonoperating revenues and expenses, costs to be recovered from revenues, capital contributions, transfers and special items.

Statements of Cash Flows

Sources and uses are classified using the direct method as resulting from operating, non-capital financing, capital and related financing or investing activities.

Notes to the Financial Statements

The notes explain information in the financial statements and provide additional detailed information.

Financial Highlights

Condensed Balance Sheets

	June 30, 2008	June 30, 2007	June 30, 2006	2008 vs. 2007	2007 vs. 2006
<i>(Dollars in Thousands)</i>					
Current assets	\$ 78,755	\$ 77,647	\$ 75,168	1 %	3 %
Capital assets, net	1,217,432	1,161,589	1,081,255	5 %	7 %
Other long-term assets	140,563	117,404	97,027	20 %	21 %
Total Assets	<u>\$ 1,436,750</u>	<u>\$ 1,356,640</u>	<u>\$ 1,253,450</u>	6 %	8 %
Current liabilities	\$ 69,712	\$ 106,471	\$ 62,314	(35) %	71 %
Long-term liabilities	1,183,387	1,092,856	1,051,020	8 %	4 %
Total Liabilities	<u>1,253,099</u>	<u>1,199,327</u>	<u>1,113,334</u>	4 %	8 %
Equity - Invested in capital assets, net of related debt	126,502	104,632	80,649	21 %	30 %
Equity - Unrestricted	57,149	52,681	59,467	8 %	(11) %
Total Equity	<u>183,651</u>	<u>157,313</u>	<u>140,116</u>	17 %	12 %
Total Liabilities and Equity	<u>\$ 1,436,750</u>	<u>\$ 1,356,640</u>	<u>\$ 1,253,450</u>	6 %	8 %

2008 Compared to 2007

Net capital assets increased \$55.8 million or 5 percent due primarily to the acquisition and construction of transmission facilities to meet increasing demand for these services. Utility plant in service also increased \$108.3 million or 8 percent because of electric plant in service additions.

Other long-term assets increased \$23.2 million or 20 percent which can mostly be attributed to a \$13.0 million decrease in restricted cash and cash equivalents, a \$7.0 million increase in restricted accounts receivable, and a \$29.1 million increase in deferred charges. The decrease in restricted cash and cash equivalents is primarily due to the use of the excess commercial paper proceeds received in fiscal year 2007 in anticipation of the pay down of tax exempt commercial paper in fiscal year 2008. The increase in restricted accounts receivable is primarily due to transfers to LCRA TSC debt service accounts because of the issuance of LCRA TSC Contract Refunding Revenue Bonds, Series 2008 and their new reserve requirements. The increase in deferred charges is primarily due to both a \$25.4 million increase in costs to be recovered as a result of more costs deferred to future period rate recoveries and a \$5.1 million increase in issue costs for the LCRA TSC Contract Refunding Revenue Bonds, Series 2008.

Additionally, current liabilities decreased \$36.8 million or 35 percent this fiscal year and long-term liabilities increased \$90.5 million or 8 percent. These variances are due to a refunding of commercial paper with LCRA TSC Contract Refunding Revenue Bonds, Series 2008.

2007 Compared to 2006

Net capital assets increased \$80.3 million or 7 percent due primarily to the acquisition and construction of transmission facilities to meet increasing demand for these services. Utility plant in service also increased \$138.3 million or 11 percent because of electric plant in service additions.

Other long-term assets increased \$20.4 million or 21 percent which can mostly be attributed to an increase in restricted cash and cash equivalents of \$11.7 million and restricted accounts receivable of \$6.6 million. The restricted funds were excess commercial paper proceeds received in anticipation of near future payments on construction projects. The issuance of LCRA Transmission Contract Refunding Revenue Bonds Series 2006A during the fiscal year has increased the restricted accounts receivable from LCRA, the holder of these bond proceeds.

Additionally, current liabilities increased \$44.2 million or 71 percent this fiscal year and long-term liabilities increased \$41.8 million or 4 percent. These changes are due to the issuance of commercial paper and LCRA Transmission Contract Refunding Revenue Bonds Series 2006A, both sources to fund upcoming construction of transmission facilities.

Condensed Statements of Revenues, Expenses and Changes in Equity

	Year Ended June 30,			2008 vs 2007	2007 vs 2006
	2008	2007	2006	Favorable/ (Unfavorable)	Favorable/ (Unfavorable)
	<i>(Dollars in Thousands)</i>				
Operating revenues	\$ 190,739	\$ 178,826	\$ 165,836	7 %	8 %
Operating expenses	(114,664)	(106,005)	(95,295)	(8) %	(11) %
Operating income	76,075	72,821	70,541	4 %	3 %
Interest and other income	4,539	10,215	3,353	(56) %	205 %
Interest and other expenses	(81,531)	(68,453)	(55,481)	(19) %	(23) %
Costs to be recovered from revenues	25,397	1,269	1,419	1901 %	(11) %
Capital contributions	1,132	1,859	2,384	(39) %	(22) %
Income before transfers in and special item	25,612	17,711	22,216	45 %	(20) %
Transfers in	726	842	829	(14) %	2 %
Special item - Loss on early defeasance of debt	-	(1,356)	(1,323)	100 %	(2) %
Change in equity	26,338	17,197	21,722	53 %	(21) %
Equity, Beginning of Year	157,313	140,116	118,394	12 %	18 %
Equity, End of Year	\$ 183,651	\$ 157,313	\$ 140,116	17 %	12 %

2008 Compared to 2007

Operating revenues are derived from providing transmission and transformation services to customers. The increase in operating revenues of \$11.9 million or 7 percent is primarily due to the Public Utility Commission of Texas (PUC) approved transmission interim rate increase to \$3.02 per kW effective Oct. 2, 2007 and the PUC approved wholesale transmission rate increase to \$3.51 per kW effective April 20, 2008.

Operating expenses of \$114.7 million include operations, maintenance and depreciation expenses, and increased \$8.7 million or 8 percent. An increase in operating expenses was primarily due to a \$4.4 million decrease in costs allocated to capital and an increase in depreciation expense of \$3.6 million due to a larger amount of plant in service as of June 30, 2008.

Interest and other income decreased \$5.7 million or 56 percent primarily due to a decrease in interest income as a result of the termination of the securities lending program in May 2007. Interest and other expenses increased \$13.1 million or 19 percent due to an increase in the amortization of losses on refunding as a result of the refunding of LCRA TSC Series 2003A bonds in April 2008, and due to a decrease in capitalized interest. LCRA TSC capitalizes interest on long-term debt to the extent that scheduled debt payments exceed the amount of debt service allowed by the PUC to be recovered in LCRA TSC's regulated rates. During FY 2008 LCRA TSC reached a settlement in its Transmission Cost of Service rate case earlier than anticipated. This settlement increased the amount of debt service allowed in LCRA TSC's rates resulting in a decrease in capitalized interest in FY 2008 compared to interest capitalized during FY 2007.

Costs to be recovered from revenues increased \$24.1 million or 1,901 percent mostly due to a decrease in principal payments on debt and an increase in the amortization of issue costs premiums and discounts primarily due to the refunding of LCRA TSC Series 2003A bonds.

No material special item was recorded in fiscal year 2008 causing a decrease of \$1.4 million or 100 percent in special item – loss on early defeasance of debt.

2007 Compared to 2006

Operating revenues are derived from providing transmission and transformation services to customers. The increase in operating revenues of \$13 million or 8 percent is primarily due to the Public Utility Commission of Texas (PUC) approved transmission interim rate increase to \$2.77 per kW effective Sept. 26, 2005.

Operating expenses of \$106 million include operations, maintenance and depreciation expenses, and increased \$10.7 million or 11 percent. An increase in operating expenses was primarily due to a decrease in the capital credit.

Interest and other income increased \$6.9 million or 205 percent due to increases in interest rates. Interest and other expenses increased \$13 million or 23 percent primarily due to an increase in the interest accrued on revenue bonds, particularly Series 2006 and 2006A bonds and an increase in interest expense from the recording of securities lending transactions.

Regulatory Matters

FY 2006 transmission revenues of \$156.2 million are the result of rate changes authorized during the fiscal year. LCRA TSC filed an interim update of wholesale transmission rates with the PUC on July 25, 2005, and the PUC Commissioners approved the new rate of \$2.77 per kW on Sept. 26, 2005. The predominant rate of \$2.77 per kW was in place from Sept. 26, 2005 through June 30, 2006.

FY 2007 transmission revenues of \$169 million are the result of rate changes authorized during the fiscal year. LCRA TSC filed an interim update of wholesale transmission rates with the PUC on July 25, 2006, and the PUC Commissioners approved the new rate of \$2.88 per kW on Sept. 21, 2006. The predominant rate of \$2.88 per kW was in place from Sept. 21, 2006 through June 30, 2007.

FY 2008 transmission revenues of \$180.2 million are the result of rate changes authorized during the fiscal year. LCRA TSC filed an interim update of wholesale transmission rates with the PUC on July 23, 2007, and the PUC Commissioners approved the new rate of \$3.02 per kW on Oct. 2, 2007. The predominant rate of \$3.02 per kW was in place from Oct. 2, 2007 through April 19, 2008. LCRA TSC filed a rate case of wholesale transmission rates with the PUC on Nov. 15, 2007, and the PUC Commissioners approved the new rate of \$3.51 per kW on April 20, 2008. LCRA TSC filed an interim update of wholesale transmission rates with the PUC on July 25, 2008.

Capital Improvement and Expansion Program

LCRA TSC's capital improvement and expansion program for FY 2009 through FY 2013 is \$928 million, with \$686.5 million or 74 percent expected to be debt funded. The prevailing drivers of spending throughout the five-year planning horizon are to address LCRA TSC system reliability requirements, respond to Electric Reliability Council of Texas (ERCOT) system needs, meet forecasted area load growth and connect new generators to the LCRA TSC electric system.

The forecasted capital program is subject to periodic review and revision and may change significantly because of a number of factors including economic conditions and regulatory constraints.

Capital Asset Activity

- \$98.6 million was charged to construction activities in FY 2008. The majority of these costs were for the construction of transmission facilities to meet increasing demands for transmission services.
- \$42.8 million of depreciation expense and asset retirements were recorded in FY 2008 on plant in service.
- For additional detail, see Capital Asset Activity table in Note 4 of the Notes to the Financial Statements.

Debt Activity

- During FY 2008, LCRA on behalf of LCRA TSC issued \$110.1 million of tax-exempt commercial paper to fund eligible project costs associated with transmission capital projects.
- On February 5, 2008, LCRA on behalf of LCRA TSC refunded \$6.4 million of LCRA TSC tax-exempt commercial paper.
- On April 22, 2008, LCRA on behalf of LCRA TSC used \$50 million of tax-exempt commercial paper proceeds to refund \$50 million of LCRA TSC Series 2003A Auction Rate bonds.
- On June 11, 2008, LCRA on behalf of LCRA TSC issued approximately \$165.2 million of Transmission Contract Refunding Revenue Bonds, Series 2008. The proceeds from the issue were used to refund \$158.6 million of tax-exempt commercial paper.
- In May 2008, LCRA on behalf of LCRA TSC made scheduled principal payments of \$1.5 million on the 2003C Refunding Revenue Bonds and \$4.2 million on the 2005 Refunding Revenue Bonds, and interest payments of \$47.4 million.
- In November 2007 and May 2008, LCRA TSC made scheduled payments of \$7.8 million and \$22.7 million respectively, on the Contractual Commitment to LCRA.
- For additional detail, see Note 3 of the Notes to the Financial Statements.

INDEPENDENT AUDITORS' REPORT

To the Board of Directors
LCRA Transmission Services Corporation
Austin, Texas

We have audited the accompanying balance sheets of the LCRA Transmission Services Corporation ("LCRA TSC") as of June 30, 2008 and 2007, and the related statements of revenues, expenses and changes in equity, and cash flows for the years then ended. These financial statements are the responsibility of LCRA TSC's management. 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 of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of LCRA TSC's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such financial statements present fairly, in all material respects, the financial position of LCRA TSC as of June 30, 2008 and 2007, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Management's Discussion and Analysis is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Deloitte & Touche LLP

October 6, 2008

LCRA TRANSMISSION SERVICES CORPORATION
BALANCE SHEETS

(Dollars in Thousands)

	June 30, 2008	June 30, 2007
<i>Assets</i>		
Current Assets		
Cash and cash equivalents	\$ 17,868	\$ 16,962
Unrestricted investments	24,960	31,591
Receivables, net	31,963	24,972
Accrued interest receivable	95	141
Inventories	3,869	3,981
Total current assets	<u>78,755</u>	<u>77,647</u>
Long-Term Assets		
Restricted cash and cash equivalents	54	13,016
Restricted investments	72	123
Accounts receivable from LCRA - restricted	51,166	44,134
Capital assets:		
Utility plant in service	1,457,870	1,349,536
Construction work in progress	36,997	53,943
Less accumulated depreciation	(277,435)	(241,890)
Capital assets, net	<u>1,217,432</u>	<u>1,161,589</u>
Deferred charges:		
Costs to be recovered from revenues	68,234	42,837
Issue costs	21,037	17,294
Deferred charges, net	<u>89,271</u>	<u>60,131</u>
Total long-term assets	<u>1,357,995</u>	<u>1,278,993</u>
Total Assets	<u>\$ 1,436,750</u>	<u>\$ 1,356,640</u>
<i>Liabilities</i>		
Current Liabilities		
Accounts payable to LCRA	\$ 7,910	\$ 14,356
Accounts payable	13,300	10,978
Bonds, notes and loans payable	48,502	81,137
Total current liabilities	<u>69,712</u>	<u>106,471</u>
Long-Term Liabilities		
Accounts payable to LCRA from Construction Fund	12,878	8,934
Accounts payable from restricted assets	7,270	11,625
Bonds, notes and loans payable	1,162,842	1,072,296
Deferred credits	397	1
Total long-term liabilities	<u>1,183,387</u>	<u>1,092,856</u>
Total liabilities	<u>1,253,099</u>	<u>1,199,327</u>
<i>Equity</i>		
Invested in capital assets, net of related debt	126,502	104,632
Unrestricted	57,149	52,681
Total equity	<u>183,651</u>	<u>157,313</u>
Total Liabilities and Equity	<u>\$ 1,436,750</u>	<u>\$ 1,356,640</u>

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

LCRA TRANSMISSION SERVICES CORPORATION
STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN EQUITY

(Dollars in Thousands)

	Year Ended June 30,	
	2008	2007
Operating Revenues		
Transmission	\$ 180,164	\$ 169,013
Transformation	9,753	9,178
Other	822	635
Total operating revenues	<u>190,739</u>	<u>178,826</u>
Operating Expenses		
Operations	66,631	61,269
Maintenance	9,372	9,669
Depreciation and amortization	38,661	35,067
Total operating expenses	<u>114,664</u>	<u>106,005</u>
Operating income	76,075	72,821
Nonoperating Revenues (Expenses)		
Interest and other income	4,539	10,215
Interest and other expenses	<u>(81,531)</u>	<u>(68,453)</u>
Total nonoperating revenues (expenses)	<u>(76,992)</u>	<u>(58,238)</u>
Income (loss) before costs to be recovered from revenues, capital contributions, transfers in, and special item	(917)	14,583
Costs To Be Recovered from Revenues	25,397	1,269
Capital Contributions	<u>1,132</u>	<u>1,859</u>
Income before transfers in and special item	25,612	17,711
Transfers In	726	842
Special Item - Loss on Early Defeasance of Debt	<u>-</u>	<u>(1,356)</u>
Change in Equity	26,338	17,197
Total Equity, Beginning of Year	<u>157,313</u>	<u>140,116</u>
Total Equity, End of Year	<u>\$ 183,651</u>	<u>\$ 157,313</u>

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

LCRA TRANSMISSION SERVICES CORPORATION
STATEMENTS OF CASH FLOWS

(Dollars in Thousands)

	Year Ended June 30,	
	2008	2007
Cash Flows From Operating Activities		
Receipts from customers	\$ 186,281	\$ 176,484
Payments to suppliers	(76,236)	(71,371)
Net cash provided by operating activities	<u>110,045</u>	<u>105,113</u>
Cash Flows From Noncapital Financing Activities		
Other expenses	(5,482)	(6,974)
Net cash used in noncapital financing activities	<u>(5,482)</u>	<u>(6,974)</u>
Cash Flows From Capital and Related Financing Activities		
Purchases of property, plant and equipment	(99,966)	(181,059)
Debt issue costs	(5,489)	(1,867)
Proceeds from long-term debt issues	173,402	137,958
Proceeds from commercial paper issues	110,100	165,000
Principal payments on long-term debt	(36,090)	(37,308)
Payments to defease and refund debt and related issue costs	(215,000)	(149,122)
Interest paid	(43,111)	(32,854)
Cash received on sale of assets	4	16
Capital contributions	1,132	1,859
Accounts payable to LCRA	(12,751)	2,105
Net cash used in capital and related financing activities	<u>(127,769)</u>	<u>(95,272)</u>
Cash Flows From Investing Activities		
Sale and maturity of investment securities	79,994	68,947
Purchase of investment securities	(72,808)	(71,312)
Interest received	3,964	8,258
Net cash provided by investing activities	<u>11,150</u>	<u>5,893</u>
Net Increase (Decrease) in Cash and Cash Equivalents	(12,056)	8,760
Cash and Cash Equivalents, Beginning of Period	29,978	21,218
Cash and Cash Equivalents, End of Period	<u>\$ 17,922</u>	<u>\$ 29,978</u>

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

LCRA TRANSMISSION SERVICES CORPORATION
STATEMENTS OF CASH FLOWS

(Dollars in Thousands)

	Year Ended June 30,	
	2008	2007
Reconciliation of Operating Income to Net Cash Flows Provided by Operating Activities		
Operating income	\$ 76,075	\$ 72,821
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation and amortization	38,661	35,067
Changes in assets and liabilities:		
Accounts receivable - trade	(6,991)	(2,344)
Inventories	112	40
Current liabilities	2,188	(471)
Net cash provided by operating activities	<u>\$ 110,045</u>	<u>\$ 105,113</u>
Noncash Investing Activities		
Investment market adjustments	<u>\$ 504</u>	<u>\$ 671</u>
Noncash Financing for Property, Plant and Equipment Expenditures		
Purchase of equipment through short-term trade payables	<u>\$ 41</u>	<u>\$ 56,206</u>

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

LCRA TRANSMISSIONS SERVICES CORPORATION

NOTES TO FINANCIAL STATEMENTS

1. Significant Accounting Policies

Reporting Entity: In connection with the implementation of retail competition in the electric utility industry in the State of Texas, the Lower Colorado River Authority (LCRA) was required by the Texas Legislature under the Public Utility Regulatory Act, enacted in 1999 as Senate Bill 7 (SB 7), to "unbundle" its electric generation assets from its electric transmission and transformation assets. Effective Jan. 1, 2002, LCRA conveyed all of its existing electric transmission and transformation assets to the LCRA Transmission Services Corporation (LCRA TSC) pursuant to the terms of an Electric Transmission Facilities Contract (the Initial Contractual Commitment), dated Oct. 1, 2001.

LCRA TSC was created under the Texas Non-Profit Corporation Act under the Development Corporation Act of 1979. TSC is organized exclusively for the benefit of accomplishing public purposes for the LCRA. Since Jan. 1, 2002, LCRA TSC has engaged in the electric transmission and transformation activities formerly carried out by LCRA and has assumed LCRA's obligation to provide, and the right to collect revenues for, electric transmission and transformation services. LCRA TSC is an electric transmission service provider (TSP) under the State's open-access electric transmission regulatory scheme within the approximately 85 percent area of the state covered by the Electric Reliability Council of Texas (ERCOT). In such capacity, LCRA TSC is entitled to receive compensation from all electric distribution service providers (DSP) using the electric transmission system within ERCOT. As a TSP in the ERCOT region of the state, the rates that LCRA TSC charges for transmission services are regulated by the Public Utility Commission of Texas (PUC) and determined pursuant to transmission cost of service (TCOS) rate proceedings filed with, and approved by, the PUC.

LCRA TSC is a component unit of LCRA. Although it is a separate legal entity, LCRA TSC is reported in LCRA's financial statements as a blended component unit because it is governed by a board of directors that is composed in its entirety of the LCRA Board of Directors.

LCRA TSC reimburses LCRA for payroll costs, including the cost of employee fringe benefits and other expenses of LCRA employees performing LCRA TSC construction, operations and maintenance work. In addition, LCRA TSC reimburses LCRA for the costs of administrative services provided to LCRA TSC. LCRA charged LCRA TSC \$181.0 million and \$240.2 million during FY 2008 and FY 2007, respectively, for these costs. The majority of these costs were for capital projects. As of June 30, 2008, total non-contractual commitment liabilities to LCRA were \$20.8 million, and receivables from LCRA were \$51.2 million. As of June 30, 2007, total non-contractual commitment liabilities to LCRA were \$23.3 million, and receivables from LCRA were \$44.1 million. Please refer to Note 3, Long-Term Debt, for contractual commitment liability information.

Basis of Accounting: The accompanying financial statements of LCRA TSC, a governmental entity and component unit of LCRA, have been prepared using proprietary fund and accrual basis accounting. LCRA TSC implements all applicable Governmental Accounting Standards Board (GASB) pronouncements and all applicable Financial Accounting Standards Board (FASB) pronouncements that do not conflict with or contradict GASB pronouncements. LCRA TSC's accounts are maintained in accordance with the Federal Energy Regulatory Commission's Uniform System of Accounts.

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements, and reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Revenues for providing electric transmission and transformation services and the costs to operate and maintain these facilities are reported as operating revenues and expenses. Revenues and expenses related to financing and other activities are reflected as non-operating.

Issued But Not Yet Effective Pronouncements: In December 2007, the FASB issued Statement No. 141 Revised, "Business Combinations." This statement addresses the treatment of assets and liabilities acquired in a business combination. The new standard requires the acquiring entity to recognize all (and only) the assets acquired and liabilities assumed in the transaction; establishes the acquisition-date fair value as the measurement objective for all assets acquired and liabilities assumed; and requires the acquirer to disclose to financial statement users all of the information they need to evaluate and understand the nature and financial effect of the business combination. This statement is effective for LCRA TSC beginning in FY 2009. The implementation of this FASB statement is not expected to have a material effect on the LCRA TSC's financial position, results of operations or cash flows.

In September 2006, the FASB issued Statement No. 157, "Fair Value Measurements". This statement defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles (GAAP), and requires additional disclosures about the LCRA TSC's financial assets and liabilities that are measured at fair value. This statement is effective for the LCRA TSC's financial assets and liabilities beginning in FY 2009. FASB

LCRA TRANSMISSIONS SERVICES CORPORATION

NOTES TO FINANCIAL STATEMENTS

Staff Position No. FAS 157-2 delays the effective date for Statement No. 157 for nonfinancial assets and liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis, to fiscal years beginning after November 15, 2008. Therefore, this statement is effective for the LCRA TSC's nonfinancial assets and liabilities beginning in FY 2010. The implementation of this FASB statement is not expected to have a material effect on the LCRA TSC's financial position, results of operations or cash flows in FY 2009. If there are any conflicts with this Statement's requirements and any current or future GASB guidance regarding fair value measurements, LCRA TSC will follow the requirements of the GASB.

In May 2008, the FASB issued Statement No. 162, "The Hierarchy of Generally Accepted Accounting Principles". This statement identifies the sources of accounting principles and the framework for selecting the principles to be used in the preparation of financial statements that are presented in conformity with GAAP. The LCRA TSC plans to adopt Statement No. 162 when it becomes effective. The adoption of this statement is not expected to have a material effect on the LCRA TSC's financial position, results of operations or cash flows.

New Adopted Standards for FY 2008: In FY 2008, LCRA TSC implemented GASB Statement No. 49, "Accounting and Financial Reporting for Pollution Remediation Obligations." This Statement identifies the circumstances under which a government entity would be required to report a liability related to pollution remediation. The guidance defines when to recognize a liability for the cost of pollution remediation in the financial statements and how to measure the amount of the liability. The suggested method to value the liability is the "expected-cash-flows" technique. The implementation of GASB No. 49 did not have a material effect on the LCRA TSC's financial position, results of operations or cash flows.

Revenue and Restricted Funds: Restricted funds consist of construction funds derived from debt issues, system revenues that have been designated for specific purposes by the Board and other funds with legal or contractual constraints.

Utility Plant: Utility plant consists of electric transmission and transformation facilities, a system operations and control center, and related projects under construction. These assets are recorded at cost, which includes materials, labor, overhead and interest capitalized during construction. The costs of repairs and minor replacements are charged to operating expense as incurred. Costs of asset replacements and betterments are capitalized. The cost of depreciable plant retired, along with removal expense less salvage value, is charged to non-operating expense on the Statement of Revenues, Expenses, and Changes in Equity. Gains and losses upon disposition are recorded in the period incurred.

Inventories: Inventories include materials and supplies to support the transmission infrastructure and are stated at the lower of cost or market.

Investments: Investments are stated at fair value. Any changes, unrealized and realized, in the fair value of financial investments are recorded as investment income.

Refunding and Defeasance of Debt: For debt refunding, the difference between the reacquisition price and the net carrying amount of the old debt is deferred and reported as a deduction from or an addition to the debt liability. For debt defeasances, the difference between the carrying amount of the debt and the amount of funds needed to retire the debt is recognized immediately in the Statements of Revenues, Expenses and Changes in Equity as a special item in FY 2007, but as interest expense in FY 2008. Prior to FY 2008, debt defeasances were reported as a special item because they were infrequent in nature and under the control of management. As of FY 2008, the LCRA has defeased debt in each of the last three fiscal years, and as such debt defeasances are no longer infrequent and are not required to be reported as a special item.

Rates and Regulations: Transmission rates within the ERCOT system are determined pursuant to a universal 100 percent "postage stamp" rate that spreads the total annual costs of transmission services among DSPs according to their electric loads. The transmission costs are determined pursuant to TCOS rate proceedings required to be filed by all TSPs, including LCRA TSC. Every electric end-use consumer in the ERCOT system pays a portion of the total costs of maintaining a reliable statewide transmission system. Transmission charges are calculated by multiplying a DSP's share of the statewide electric load by the statewide "postage stamp" rate of each transmission service provider. The load shares and rates are determined by the PUC through its TCOS regulatory process. Additionally, pursuant to a tariff approved by the PUC, LCRA TSC collects revenues for transformation services, providing transformers that "step down" voltage from levels appropriate for transmission to lower levels for distribution.

LCRA TRANSMISSIONS SERVICES CORPORATION NOTES TO FINANCIAL STATEMENTS

A monthly charge for each transformation delivery point is authorized under the transformation tariff. LCRA TSC also collects monthly metering service revenues based on a per meter charge according to the PUC approved tariff.

FY 2007 transmission revenues of \$169 million are the result of rate changes authorized during FY 2007. The predominant rate of \$2.88 per kW was in place from Sept. 21, 2006 through June 30, 2007. LCRA TSC filed an interim update of wholesale transmission rates with the PUC on July 25, 2006. The filing, Docket No. 32987, was approved by the PUC Commissioners on Sept. 21, 2006. The approved rate was \$2.88 per kW, effective as of Sept. 21, 2006.

FY 2008 transmission revenues of \$180.2 million are the result of rate changes authorized during the fiscal year. The predominant rate of \$3.02 was in place from Oct. 2, 2007 through April 19, 2008. LCRA TSC filed an interim update of wholesale transmission rates with the PUC on July 23, 2007, and the PUC Commissioners approved the new rate of \$3.02 per kW on Oct. 2, 2007. On Nov. 15, 2007 LCRA TSC filed a wholesale transmission rate case with the PUC and the PUC Commissioners approved the new rate of \$3.51 effective April 20, 2008. LCRA TSC filed an interim update of wholesale transmission rates with the PUC on July 25, 2008.

Regulatory Assets and Liabilities: LCRA TSC applies the accounting requirements of FASB Statement of Financial Accounting Standards No. 71 (SFAS 71), "Accounting for the Effects of Certain Types of Regulation." Accordingly, certain costs may be capitalized as a regulatory asset that would otherwise be charged to expense. A regulatory asset is recorded when it is probable that future revenue in an amount at least equal to the capitalized costs will result from inclusion of those costs in future rates. In addition, rate actions of the regulator may impose a liability. A regulatory liability occurs when a regulator requires refunds to customers or provides current rates intended to recover costs that are expected to be incurred in the future. A regulatory asset is amortized over the life of the related outstanding long-term debt, while a regulatory liability is recognized and charged to income when the associated costs are incurred. LCRA TSC's regulatory assets amounted to \$68.2 and \$42.8 million at June 30, 2008 and 2007, respectively. The regulatory assets, which are included under deferred charges, consist of depreciation of debt-funded assets and costs related to outstanding debt. Debt-funded costs are deferred pending future recovery through the inclusion of the related debt service in rates.

Capitalized Interest: Interest is capitalized as a part of the cost of capital assets if the interest is financed by debt proceeds. During FY 2008 and 2007, LCRA TSC capitalized \$4.1 million and \$10.1 million of interest, respectively.

Impairment: LCRA TSC evaluates the carrying value of its property, plant and equipment, and other long-lived assets when major events or changes in circumstances indicate a decline in an asset's service capacity. Impairment is measured using methods that isolate the asset's service capacity that has been rendered unusable.

Depreciation and Amortization: LCRA TSC depreciates its utility plant in service on a straight-line basis over the estimated useful lives of the various classes of these assets. Depreciation expense, expressed as a percentage of average depreciable utility plant, was approximately 2.81 percent for FY 2008 and 2.74 percent for FY 2007. Depreciation expense for FY 2008 and FY 2007 was approximately \$38.7 million and \$35.1 million, respectively.

The estimated useful life of property, plant and equipment by major category is as follows:

Transmission Plant	5 – 65 years
General Plant	4 – 45 years

Periodically, LCRA TSC reviews the useful lives of depreciable assets. Changes in useful lives are accounted for as a change in accounting estimate in accordance with Statement of Financial Accounting Standard No. 154, *Accounting Changes and Error Corrections*. In FY 2008, a change in the estimated life of certain transmission capital assets was necessitated by related technological advances and construction material used. The change in the estimated lives of these assets decreased depreciation and amortization expense by \$0.6 million on the Statement of Revenues, Expenses and Changes in Equity for the year ended June 30, 2008 and could decrease depreciation and amortization expense by up to \$2.5 million in each future year that those assets are still in service.

Gains or losses created by refunding transactions are amortized over the shorter of the remaining terms of the new issues or the refunded bonds. Amortization of debt discount and premium is computed using the interest method over the life of the related bond issues. Amortization of debt issue cost is computed on the straight-line method over the life of the related bond issues, which approximates the interest method.

LCRA TRANSMISSIONS SERVICES CORPORATION NOTES TO FINANCIAL STATEMENTS

Statements of Cash Flow: All highly liquid investments (including investments in restricted funds) with an original maturity of 90 days or less are considered cash equivalents.

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

2. Financial Instruments

As of June 30, 2008 and 2007, LCRA TSC had the following investments and maturities:

Type of Investment	June 30, 2008		June 30, 2007	
	Market Value ₁	WAM (Years) ₂	Market Value ₁	WAM (Years) ₂
Investments				
U.S. Government Securities	\$ 15,128	0.63	\$ 31,714	0.67
U.S. Agency Discount Notes	9,904	0.40	-	-
Cash Equivalents				
Commercial Paper	6,000	0.16	6,000	0.15
Money Market Fund	11,871	0.22	23,929	0.10
Total	<u>\$ 42,903</u>	0.40	<u>\$ 61,643</u>	0.40

Cash and investments as of June 30, 2008 and 2007 consisted of the following:

Cash	\$ 51	\$ 49
Investments	42,903	61,643
	<u>\$ 42,954</u>	<u>\$ 61,692</u>

₁ Dollars in Thousands

₂ Weighted Average Maturity

External Investments Pool: LCRA TSC investments included a money market fund with TexPool at June 30, 2008 and 2007. The State Comptroller of Public Accounts oversees TexPool and the pool seeks to maintain a \$1 value per share as required by the Texas Public Fund Investment Act. There are no minimum balance requirements for TexPool participants, and there is no limit on the number of accounts per participant.

Interest Risk: LCRA TSC has no formal policy to address exposure to fair value losses resulting from changes in interest rates. However, in accordance with management policy, LCRA TSC manages its exposure to rising interest rates by investing a majority of its investment portfolio in securities with short-term maturities and holding investments to maturity.

Credit Risk: LCRA TSC's investment activities are governed by state statute (Public Funds Investment Act) which specifies the type and ratings of investments governmental entities are allowed to purchase. LCRA Board policy, internal operating procedures and applicable bond resolutions further restrict investment activity. At June 30, 2008 and 2007, LCRA TSC's investment in the investment pool (money market) was rated AAAM by Standard & Poor's. Investments in commercial paper were rated A-1+ by Standard & Poor's and P-1 by Moody's Ratings. Investments in US Agencies were rated Aaa by Moody's Ratings.

Concentration of Credit Risk: As of June 30, 2008, LCRA TSC had commercial paper representing 13.99% of LCRA TSC investments from a single issuer. LCRA TSC has no formal policy to limit the amount that may be invested in any one issuer. The Public Funds Investment Act requires investments in commercial paper to be rated A-1, P-1, or an equivalent rating. However, LCRA TSC's internal investment strategy requires higher commercial paper ratings of A-1+ or P-1, and management closely monitors the portfolio mix to provide diversity and limit concentration.

LCRA TRANSMISSIONS SERVICES CORPORATION NOTES TO FINANCIAL STATEMENTS

Estimation of Fair Value: The carrying amounts of receivables and certain other liabilities approximate market value due to the short maturity of these instruments. The estimated market value of long-term debt, based on current market yields, was \$1.1 billion and \$1.0 billion at June 30, 2008 and 2007, respectively.

3. Long-Term Debt

Changes during FY 2008 and FY 2007, of long-term debt, including current portions are as follows (in thousands):

Series	May 15,		Balance June 30, 2006	Increase (Decrease)	Balance June 30, 2007	Increase Decreases	Balance June 30, 2008	Amount Due ⁽³⁾ in FY 2009
	From	To						
Series 2003A (Auction Rate) ⁽¹⁾	2030	2032	\$ 50,000	\$	\$ 50,000	\$ (50,000)	\$ -	\$
Series 2003B (5.00%-5.375%)	2009	2031	237,240	(7,690)	229,550		229,550	7,690
Series 2003C (5.00%-5.25%)	2009	2033	125,560	(4,565)	120,995	(1,470)	119,525	4,515
Series 2004 (3.00%-5.00%)	2009	2034	125,490	(8,255)	117,235		117,235	4,170
Series 2005 (3.50%-5.00%)	2009	2035	126,095		126,095	(4,175)	121,920	4,190
Series 2006 (4.50%-5.00%)	2009	2036	135,925	(4,270)	131,655		131,655	4,485
Series 2006A (4.00%-5.00%)	2009	2036	-	133,585	133,585		133,585	4,490
Series 2008 (5.00%-5.25%)	2011	2035	-		-	165,205	165,205	
Contractual Commitment (6.06%) ⁽²⁾	2009	2032	457,903	(32,151)	425,752	(30,445)	395,307	28,424
Less: Unamortized Net Discount			(151,597)	17,047	(134,550)	20,464	(114,086)	(9,444)
Subtotal			\$ 1,106,616	\$ 93,701	\$ 1,200,317	\$ 99,579	\$ 1,299,896	\$ 48,520
Unamortized Net Losses on Refunded Debt			(111,929)	5,045	(106,884) ⁽⁴⁾	13,232	(93,652) ⁽⁵⁾	(5,118)
Tax Exempt Commercial Paper (Variable Rate)			25,000	35,000	60,000	(54,900)	5,100	5,100
Total			\$ 1,019,687	\$ 133,746	\$ 1,153,433	\$ 57,911	\$ 1,211,344	\$ 48,502

(1) Auction Rate debt was redeemed in full on April 22, 2008.

(2) Matures November 15 and May 15.

(3) The total amount due in FY 2008 is \$ 81.1 million.

(4) \$55,633 is associated with LCRA 1999 A-I refunding bonds and \$51,251 is associated with LCRA TSC 2003A and 2003B refunding bonds.

(5) \$51,568 is associated with LCRA 1999 A-I refunding bonds and \$42,084 is associated with LCRA 2003B refunding bonds.

LCRA TSC's debt as of June 30, 2008, has been rated by Fitch, Moody's and Standard & Poor's, respectively, as follows:

Fitch, Moody's and Standard & Poor's

Transmission Services Contract Refunding Revenue Bonds: A+, A2, A (Uninsured)

Transmission Services Commercial Paper: F-1+, P-1, A-1+

Bond debt payments, excluding commercial paper, are as follows (in thousands):

Ending June 30	Principal	Interest	Total
2009	57,963	49,660	107,623
2010	58,043	48,957	107,000
2011	60,062	47,564	107,626
2012	61,651	45,963	107,614
2013	63,342	44,268	107,610
2014-2018	322,764	192,962	515,726
2019-2023	260,874	143,577	404,451
2024-2028	207,765	96,618	304,383
2029-2033	221,838	51,216	273,054
2034-2037	99,680	8,605	108,285
	1,413,982	729,390	2,143,372
Unamortized Net Discount	(114,086)		(114,086)
Total	\$ 1,299,896	\$ 729,390	\$ 2,029,286

LCRA TRANSMISSIONS SERVICES CORPORATION

NOTES TO FINANCIAL STATEMENTS

New and Refunding Bonds: During FY 2008, LCRA on behalf of LCRA TSC issued \$110.1 million of tax-exempt commercial paper to fund eligible project costs associated with transmission capital projects and to refund bonds.

On April 22, 2008 LCRA TSC used \$50 million of tax-exempt commercial paper proceeds to refund \$50 million of TSCorp 2003A Auction Rate bonds.

On June 11, 2008, LCRA on behalf of LCRA TSC issued \$165.2 million of Transmission Contract Refunding Bonds, Series 2008. The proceeds from the bonds issuance were used to refund \$158.6 million of tax-exempt commercial paper which included the \$50 million issued to refund the TSCorp 2003A Auction Rate bonds.

During FY 2007, LCRA on behalf of LCRA TSC issued \$165 million of tax-exempt commercial paper to fund eligible project costs associated with transmission capital projects.

On December 6, 2006, LCRA on behalf of LCRA TSC issued \$133.6 million of Transmission Contract Refunding Bonds, Series 2006A. The proceeds from the bonds issuance were used to refund \$130 million of tax-exempt commercial paper.

On April 26, 2007, LCRA on behalf of LCRA TSC deposited funds into an escrow account to defease approximately \$19 million of debt from the LCRA TSC Series 2003B, 2003C, 2004 and 2006 Contract Refunding Revenue Bonds. Pursuant to the stipulations of the Revenue Bonds and in the opinion of LCRA's Bond Counsel, the repayment of these obligations constitutes a legal defeasance. The defeasance reduced future debt service requirements.

The principal associated with the bonds that have been previously refunded by LCRA TSC but remain outstanding at June 30, 2008 and 2007, totals \$0 million and \$19 million, respectively. Proceeds from these refunding bond issues were escrowed to purchase U.S. government obligations that will mature at such time and yield interest in such amounts so that sufficient monies are available for payment of principal, premium, if any, and interest on the refunded bonds when due. None of these refunded bonds are included in LCRA TSC's outstanding long-term debt at June 30, 2008 and 2007.

All LCRA Transmission Contract Revenue debt is solely secured by the obligation of LCRA TSC to make Installment Payments to LCRA from the Net Revenues of LCRA TSC (subordinate to first lien on Gross Revenues securing Purchase Price Payments under the Initial Contractual Commitment). Net revenues are defined as Gross Revenues less any Purchase Price Payments due to LCRA and less the Operating and Maintenance Expenses during the period.

Contractual Commitment: Concurrent with the transfer by LCRA of transmission and transformation assets to LCRA TSC on January 1, 2002, in order to comply with the requirements of SB7, LCRA TSC assumed responsibility for its share of LCRA's debt service in return for such assets. This obligation is evidenced by a contract executed between LCRA TSC and LCRA whereby LCRA TSC is responsible for payments equal to the scheduled debt service attributable to LCRA TSC. The total semiannual payments to be made by LCRA TSC to LCRA from May 15, 2002, until May 15, 2032, are \$596 million. The present value of these payments equals \$334 million. The difference between the future payment amounts and the present value of the payments represents imputed interest. The amortization of the imputed interest and principal of the note payable was amortized using the interest method. The effective interest rate of the note is 6.06 percent. In addition to the asset transfer on Jan. 1, 2002, a net premium of \$6.4 million and a net loss on refunded bonds of \$72 million associated with past LCRA bond issues were transferred to the LCRA TSC.

Commercial Paper: LCRA TSC is authorized to issue tax-exempt commercial paper notes in an aggregate amount of principal and interest not to exceed \$250 million under its commercial paper program. The commercial paper program expires on May 15, 2042. It is management's intent to periodically renew outstanding commercial paper upon maturity, and to periodically convert the commercial paper balances to long-term bonds.

LCRA TSC maintains credit facilities with banks that provide available borrowing sufficient to pay the principal and interest on the notes. A \$150 million credit agreement is available to pay \$137 million of principal and \$13 million of interest. This agreement expires on April 29, 2009. Another credit agreement of \$100 million is available to pay \$91 million of principal and \$9 million of interest. This credit agreement expired on August 27, 2008. Management did not renew the credit agreement. Failure by LCRA or LCRA TSC to meet certain restrictive covenants could result in the withdrawal of the banks' commitments for the unused line of credit. There were no borrowings under either credit facility agreement as of June 30, 2008.

Optional Redemption: The Transmission Contract Refunding Revenue Bonds, Series 2008, that mature on or after May 15, 2019, are redeemable at the option of LCRA, on May 15, 2018, or on any date thereafter, in whole or in part, in principal amounts of \$5,000 or integral multiples thereof (and if in part, the particular bonds or portions

LCRA TRANSMISSIONS SERVICES CORPORATION

NOTES TO FINANCIAL STATEMENTS

thereof to be redeemed shall be selected by LCRA in its sole discretion) at a redemption price equal to the principal amount of such bonds to be redeemed, plus accrued interest to the redemption date.

The Transmission Contract Refunding Revenue Bonds, Series 2006A, that mature on or after May 15, 2017, are redeemable at the option of LCRA, on May 15, 2016, or on any date thereafter, in whole or in part, in principal amounts of \$5,000 or integral multiples thereof (and if in part, the particular bonds or portions thereof to be redeemed shall be selected by LCRA in its sole discretion) at a redemption price equal to the principal amount of such bonds to be redeemed, plus accrued interest to the redemption date.

The Transmission Contract Refunding Revenue Bonds, Series 2006, that mature on or after May 15, 2012, are redeemable at the option of LCRA, on May 15, 2011, or on any date thereafter, in whole or in part, in principal amounts of \$5,000 or integral multiples thereof (and if in part, the particular bonds or portions thereof to be redeemed shall be selected by LCRA in its sole discretion) at a redemption price equal to the principal amount of such bonds to be redeemed, plus accrued interest to the redemption date.

The Transmission Contract Refunding Revenue Bonds, Series 2005, that mature on or after May 15, 2012, are redeemable at the option of LCRA, on May 15, 2011, or on any date thereafter, in whole or in part, in principal amounts of \$5,000 or integral multiples thereof (and if in part, the particular bonds or portions thereof to be redeemed shall be selected by LCRA in its sole discretion) at a redemption price equal to the principal amount of such bonds to be redeemed, plus accrued interest to the redemption date.

The Transmission Contract Refunding Revenue Bonds, Series 2004, that mature on or after May 15, 2012, are redeemable at the option of LCRA, on May 15, 2011, or on any date thereafter, in whole or in part, in principal amounts of \$5,000 or integral multiples thereof (and if in part, the particular bonds or portions thereof to be redeemed shall be selected by LCRA in its sole discretion) at a redemption price equal to the principal amount of such bonds to be redeemed, plus accrued interest to the redemption date.

The Transmission Contract Refunding Revenue Bonds, Series 2003B, that mature on and after May 15, 2013, are redeemable at the option of LCRA, on May 15, 2012, or on any date thereafter, in whole or in part, in principal amounts of \$5,000 or integral multiples thereof (and if in part, the particular bonds or portions thereof to be redeemed shall be selected by LCRA in its sole discretion) at a redemption price equal to the principal amount of such bonds to be redeemed, plus accrued interest to the redemption date.

The Transmission Contract Refunding Revenue Bonds, Series 2003C, that mature on and after May 15, 2014, are redeemable at the option of LCRA, on May 15, 2013, or on any date thereafter, in whole or in part, in principal amounts of \$5,000 or integral multiples thereof (and if in part, the particular bonds or portions thereof to be redeemed shall be selected by LCRA in its sole discretion) at a redemption price equal to the principal amount of such bonds to be redeemed, plus accrued interest to the redemption date.

Mandatory Redemption: A number of LCRA TSC term bonds are subject to mandatory redemption at the redemption price which equals the principal amount thereof plus accrued interest to the redemption date. The particular bonds or portions thereof to be redeemed are to be selected and designated by LCRA (provided that a portion of a Bond may be redeemed only in an integral multiple of \$5,000). The mandatory redemption dates range from May 15, 2022 to May 15, 2036.

LCRA TRANSMISSIONS SERVICES CORPORATION

NOTES TO FINANCIAL STATEMENTS

4. Capital Assets and Depreciation

Capital asset activity for the year ended June 30, 2008 was as follows:

	Beginning Balance	Additions	Transfers from Construction in Progress	Transfers to LCRA	Retirements	Depreciation	Transfers In/Out	Ending Balance
<i>(Dollars in Thousands)</i>								
Utility plant in service								
Depreciable assets	\$ 1,278,014	\$	\$ 104,340	\$	\$ (7,224)	\$	\$ (675)	\$ 1,374,455
Non-Depreciable assets	71,522		11,218				675	83,415
Total Utility Plant in Service	1,349,536		115,558		(7,224)		-	1,457,870
Construction work in progress								
Non-Depreciable assets	53,943	98,612	(115,558)					36,997
Less Accumulated Depreciation	(241,890)				3,116	(38,661)		(277,435)
Capital Assets, Net	\$ 1,161,589	\$ 98,612	\$ -	\$ -	\$ (4,108)	\$ (38,661)	\$ -	\$ 1,217,432

Capital asset activity for the year ended June 30, 2007 was as follows:

	Beginning Balance	Additions	Transfers from Construction in Progress	Transfers to LCRA	Retirements	Depreciation	Transfers In/Out	Ending Balance
Utility plant in service								
Depreciable assets	\$ 1,206,795	\$ (23)	\$ 140,135	\$ (644)	\$ (18,670)	\$	\$ (49,579)	\$ 1,278,014
Non-Depreciable assets	4,392		17,566		(15)		49,579	71,522
Total Utility Plant in Service	1,211,187	(23)	157,701	(644)	(18,685)	-	-	1,349,536
Construction work in progress								
Non-Depreciable assets	87,565	124,079	(157,701)					53,943
Less Accumulated Depreciation	(217,497)			122	10,542	(35,057)		(241,890)
Capital Assets, Net	\$ 1,081,255	\$ 124,056	\$ -	\$ (522)	\$ (8,143)	\$ (35,057)	\$ -	\$ 1,161,589

5. Commitments and Contingencies

Construction: LCRA TSC's construction budget provides for capital improvement and expansion projects with cash requirements through FY 2013 of approximately \$928 million, including \$128.6 million in FY 2009. LCRA TSC's forecasted capital program includes \$211.4 million for the Clear Springs/Zorn-Hutto Project. The LCRA TSC is proposing to build a new 345-kilovolt double-circuit transmission line. The proposed project, in conjunction with another transmission line project being constructed by TXU Electric Delivery (TXU ED) north of the Hutto switching station, will address several regional transmission needs and has been recommended by the Electric Reliability Council of Texas (ERCOT).

LCRA TRANSMISSIONS SERVICES CORPORATION

NOTES TO FINANCIAL STATEMENTS

Customer Transmission Leases: In addition to the transmission and transformation assets owned by LCRA TSC, certain leases of transmission assets owned by 11 of LCRA's wholesale electric customers and leased to LCRA have been assigned to LCRA TSC. The leases are the basis for LCRA TSC to provide the same service to all of the wholesale electric customers and for the cost of such service to be shared by all customers on a consistent basis. Payments for the lease facilities vary from year to year and are based on the original cost of the facilities, adjusted for depreciation, and are updated annually to reflect additions, retirements and depreciation. The terms of the leases are perpetual, but may be terminated by LCRA or the lessors upon five years written notice. Lease expenses were \$11.4 million annually in FY 2007 and 2008.

The following is a schedule by years of current and future minimum rental payments required under these operating leases for the remaining non-cancelable lease terms as of June 30, 2008 (in thousands).

Fiscal Year	Minimum Lease Payments
2008	\$ 11,417
2009	11,645
2010	11,878
2011	12,115
2012	12,358
2013	12,605

Insurance: LCRA TSC's assets, other than transmission lines, are covered under LCRA's insurance program, which includes the purchase of commercial insurance and a self-insurance program to finance risk of loss. LCRA TSC pays for the insurance premiums based on the covered transmission asset values. LCRA TSC is exposed to various risks of loss related to torts; theft of, damage to and destruction of assets; errors and omissions; and natural disasters. Self-funding of property damage varies from \$100,000 to \$2.5 million depending on the insurance deductible. Any claims or damages above self-funded amounts are covered by commercial insurance. Based on an insurance risk analysis, LCRA TSC carries no commercial insurance on transmission lines.

Litigation: There are various lawsuits in which LCRA TSC is involved. LCRA TSC's management, including its general counsel, estimates that the potential claims against LCRA TSC not covered by insurance resulting from such litigation would not materially affect LCRA TSC's financial position, results of operations and cash flows.

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APPENDIX E

FORM OF OPINION OF BOND COUNSEL

An opinion in substantially the following form will be delivered by McCall, Parkhurst & Horton L.L.P., Bond Counsel, upon the delivery of the Bonds, assuming no material changes in facts or law.

**LOWER COLORADO RIVER AUTHORITY
REFUNDING REVENUE BONDS, SERIES 2008A
in the Aggregate Principal Amount of
\$209,645,000**

AS BOND COUNSEL for Lower Colorado River Authority ("LCRA"), we have examined into the legality and validity of the issue of bonds described above (the "Bonds"), which bear interest in the manner and from the dates and mature on the dates specified in the text of the Bonds, and which are subject to redemption, all in accordance with the Resolution, hereinafter defined. On September 22, 1999 and on October 15, 2008, respectively, the Board of Directors of LCRA authorized the Master Resolution Establishing the Lower Colorado River Authority Revenue Financing Program (the "Master Resolution") and the Twenty-Eighth Supplemental Resolution (the "Twenty-Eighth Supplement") to the Master Resolution authorizing the Bonds. The Master Resolution and the Twenty-Eighth Supplement are collectively referred to as the "Resolution." Terms not defined in this opinion shall have the meanings given said terms in the Resolution.

WE HAVE EXAMINED the applicable and pertinent provisions of the Constitution and laws of the State of Texas; a transcript of certified proceedings of LCRA relating to the authorization, issuance, sale and delivery of the Bonds, including the Resolution; certificates and opinions of officials of LCRA; and other pertinent instruments relating to the issuance of the Bonds. We have also examined one of the executed Bonds which we found to be in due form and properly executed.

BASED ON SAID EXAMINATION, it is our opinion that the Bonds have been duly authorized, issued and delivered in accordance with law; that the Bonds are valid and legally binding special obligations of LCRA except as the enforceability thereof may be limited by laws applicable to LCRA relating to bankruptcy, insolvency, reorganization, moratorium, liquidation and other similar laws now or hereafter enacted relating to creditors' rights generally or by general principles of equity which permit the exercise of judicial discretion; and that the interest on and principal of the Bonds, together with LCRA's other Parity Debt issued previously, are payable from and equally secured by a lien on and pledge of the Pledged Revenues of LCRA, subject only to any Prior Encumbered Obligations.

SUBJECT TO SATISFYING the terms and conditions stated in the Resolution, LCRA has reserved the right to issue additional Parity Debt payable solely from and equally and ratably secured by a parity lien on and pledge of the Pledged Revenues, subject only to any Prior Encumbered Obligations. The Resolution also authorizes LCRA to issue Subordinate Lien Obligations secured by a pledge of and lien on the Pledged Revenues subordinate to the pledge and lien securing the payment of the Bonds. In addition, LCRA has reserved the right, subject to the restrictions stated in the Resolution, to amend the Resolution.

THE REGISTERED OWNERS of the Bonds shall never have the right to demand payment of the principal thereof or interest thereon out of any funds raised or to be raised by taxation, or from any source whatsoever other than specified in the Resolution.

IT IS FURTHER OUR OPINION, except as discussed below, that the interest on the Bonds is excludable from the gross income of the owners thereof for federal income tax purposes under the statutes, regulations, published rulings, and court decisions existing on the date of this opinion. We are further of the

opinion that the Bonds are not "specified private activity bonds" and that, accordingly, interest on the Bonds will not be included as an individual or corporate alternative minimum tax preference item under section 57(a)(5) of the Internal Revenue Code of 1986, as amended (the "Code"). In expressing the aforementioned opinions, we have relied on certain representations, the accuracy of which we have not independently verified, and assume compliance by LCRA with certain covenants, regarding the use and investment of the proceeds of the Bonds and the use of the property financed or refinanced therewith. We call your attention to the fact that if such representations are determined to be inaccurate or upon a failure by LCRA to comply with such covenants, interest on the Bonds may become includable in gross income retroactively to the date of issuance of the Bonds.

OUR OPINIONS ARE BASED ON EXISTING LAW, which is subject to change. Such opinions are further based on our knowledge of facts as of the date hereof. We assume no duty to update or supplement our opinions to reflect any facts or circumstances that may thereafter come to our attention or to reflect any changes in any law that may thereafter occur or become effective. Moreover, our opinions are not a guarantee of a result and are not binding on the Internal Revenue Service (the "Service"); rather, such opinions represent our legal judgment based upon our review of existing law and in reliance upon the representations and covenants referenced above that we deem relevant to such opinions. The Service has an ongoing audit program to determine compliance with rules that relate to whether interest on state or local obligations is includable in gross income for federal income tax purposes. No assurance can be given whether or not the Service will commence an audit of the Bonds. If an audit is commenced, in accordance with its current published procedures the Service is likely to treat LCRA as the taxpayer. We observe that LCRA has covenanted not to take any action, or omit to take any action within its control, that if taken or omitted, respectively, may result in the treatment of interest on the Bonds as includable in gross income for federal income tax purposes.

EXCEPT AS STATED ABOVE, we express no opinion as to any other federal, state, or local tax consequences of acquiring, carrying, owning, or disposing of the Bonds. In particular, but not by way of limitation, we express no opinion with respect to the federal, state or local tax consequences arising from the enactment of any pending or future legislation.

WE CALL YOUR ATTENTION TO THE FACT that the interest on tax-exempt obligations, such as the Bonds, is included in a corporation's alternative minimum taxable income for purposes of determining the alternative minimum tax imposed on corporations by section 55 of the Code.

OUR SOLE ENGAGEMENT in connection with the issuance of the Bonds is as Bond Counsel for LCRA, and, in that capacity, we have been engaged by LCRA for the sole purpose of rendering an opinion with respect to the legality and validity of the Bonds under the Constitution and laws of the State of Texas, and with respect to the exclusion from gross income of the interest on the Bonds for federal income tax purposes, and for no other reason or purpose. We have not been requested to investigate or verify, and have not independently investigated or verified any records, data, or other material relating to the financial condition or capabilities of LCRA, or the disclosure thereof in connection with the sale of the Bonds, and have not assumed any responsibility with respect thereto. We express no opinion and make no comment with respect to the marketability of the Bonds and have relied solely on certificates executed by officials of LCRA as to the current outstanding indebtedness of LCRA and the sufficiency of the Pledged Revenues of LCRA. Our role in connection with LCRA's Official Statement prepared for use in connection with the sale of the Bonds has been limited as described therein.

THE FOREGOING OPINIONS represent our legal judgment based upon a review of existing legal authorities that we deem relevant to render such opinions and are not a guarantee of a result.

Respectfully,

APPENDIX F

LCRA INVESTMENT POLICY AND INVESTMENT PRACTICES

LCRA invests its funds in accordance with Board Policy 306 of LCRA, Texas law, the respective bond resolutions of LCRA and other internal management investment policies of LCRA.

Under Texas law, LCRA is authorized to invest in (1) obligations of the United States or its agencies and instrumentalities, including letters of credit; (2) direct obligations of the State of Texas or its agencies and instrumentalities; (3) collateralized mortgage obligations directly issued by a federal agency or instrumentality of the United States, the underlying security for which is guaranteed by an agency or instrumentality of the United States; (4) other obligations, the principal and interest of which is guaranteed or insured by or backed by the full faith and credit of, the State of Texas or the United States or their respective agencies and instrumentalities; (5) obligations of states, agencies, counties, cities, and other political subdivisions of any state rated as to investment quality by a nationally recognized investment rating firm not less than A or its equivalent; (6) bonds issued, assumed or guaranteed by the State of Israel; (7) certificates of deposit meeting the requirements of the Texas Public Funds Investment Act (Chapter 2256, Texas Government Code) that are issued by or through an institution that either has its main office or a branch in Texas, and are guaranteed or insured by the Federal Deposit Insurance Corporation or the National Credit Union Share Insurance Fund, or are secured as to principal by obligations described in clauses (1) through (6) or in any other manner and amount provided by law for LCRA deposits; (8) fully collateralized repurchase agreements that have a defined termination date, are fully secured by obligations described in clause (1), and are placed through a primary government securities dealer or a financial institution doing business in the State of Texas; (9) certain bankers' acceptances with the remaining term of 270 days or less, if the short-term obligations of the accepting bank or its parent are rated at least A-1 or P-1 or the equivalent by at least one nationally recognized credit rating agency; (10) commercial paper with a stated maturity of 270 days or less that is rated at least A-1 or P-1 or the equivalent by either (a) two nationally recognized credit rating agencies or (b) one nationally recognized credit rating agency if the paper is fully secured by an irrevocable letter of credit issued by a U.S. or state bank; (11) no-load money market mutual funds registered with and regulated by the Securities and Exchange Commission that have a dollar weighted average stated maturity of 90 days or less and include in their investment objectives the maintenance of a stable net asset value of \$1 for each share; and (12) no-load mutual funds registered with the Securities and Exchange Commission that have an average weighted maturity of less than two years, invest exclusively in obligations described in this paragraph, and are continuously rated as to investment quality by at least one nationally recognized investment rating firm of not less than AAA or its equivalent. In addition, bond proceeds may be invested in guaranteed investment contracts that have a defined termination date and are secured by obligations, including letters of credit, of the United States or its agencies and instrumentalities in an amount at least equal to the amount of bond proceeds invested under such contract, other than the prohibited obligations described below.

A political subdivision such as LCRA may enter into securities lending programs if (i) the securities loaned under the program are 100% collateralized, a loan made under the program allows for termination at any time and a loan made under the program is either secured by (a) obligations that are described in clauses (1) through (6) above, (b) irrevocable letters of credit issued by a state or national bank that is continuously rated by a nationally recognized investment rating firm at not less than A or its equivalent or (c) cash invested in obligations described in clauses (1) through (6) above, clauses (10) through (12) above, or an authorized investment pool; (ii) securities held as collateral under a loan are pledged to LCRA, held in LCRA's name and deposited at the time the investment is made with LCRA or a third party designated by LCRA; (iii) a loan made under the program is placed through either a primary government securities dealer or a financial institution doing business in the State of Texas; and (iv) the agreement to lend securities has a term of one year or less.

LCRA may invest in such obligations directly or through government investment pools that invest solely in such obligations provided that the pools are rated no lower than AAA or AAAM or an equivalent by at least one nationally recognized rating service. LCRA may also contract with an investment management firm registered

under the Investment Advisers Act of 1940 (15 U.S.C. Section 80b-1 et seq.) or with the State Securities Board to provide for the investment and management of its public funds or other funds under its control for a term up to two years, but LCRA retains ultimate responsibility as fiduciary of its assets. In order to renew or extend such a contract, LCRA must do so by order, ordinance, or resolution.

LCRA is specifically prohibited from investing in: (1) obligations whose payment represents the coupon payments on the outstanding principal balance of the underlying mortgage-backed security collateral and pays no principal; (2) obligations whose payment represents the principal stream of cash flow from the underlying mortgage-backed security and bears no interest; (3) collateralized mortgage obligations that have a stated final maturity of greater than 10 years; and (4) collateralized mortgage obligations the interest rate of which is determined by an index that adjusts opposite to the changes in a market index.

Under Texas law, LCRA is required to invest its funds under written investment policies that primarily emphasize safety of principal and liquidity; that address investment diversification, yield, maturity, and the quality and capability of investment management; and that include a list of authorized investments for LCRA funds, the maximum allowable stated maturity of any individual investment and the maximum average dollar-weighted maturity allowed for pooled fund groups. All LCRA funds must be invested consistent with a formally adopted "Investment Strategy Statement" that specifically addresses each fund's investment. Each Investment Strategy Statement will describe its objectives concerning: (1) suitability of investment type, (2) preservation and safety of principal, (3) liquidity, (4) marketability of each investment, (5) diversification of the portfolio, and (6) yield.

Under Texas law, LCRA's investments must be made "with judgment and care, under prevailing circumstances, that a person of prudence, discretion, and intelligence would exercise in the management of the person's own affairs, not for speculation, but for investment considering the probable safety of capital and the probable income to be derived." At least quarterly LCRA's investment officers must submit an investment report to the LCRA Board detailing: (1) the investment position of LCRA, (2) that all investment officers jointly prepared and signed the report, (3) the beginning market value, and any additions and changes to market value and the ending value of each pooled fund group, (4) the book value and market value of each separately listed asset at the beginning and end of the reporting period, (5) the maturity date of each separately invested asset, (6) the account or fund or pooled fund group for which each individual investment was acquired, and (7) the compliance of the investment portfolio as it relates to: (a) adopted investment strategies and (b) Texas law. No person may invest LCRA funds without express written authority from the LCRA Board.

Under Texas law, LCRA is additionally required to: (1) annually review its adopted policies and strategies, (2) require any investment officers with personal business relationships or family relationships with firms seeking to sell securities to LCRA to disclose the relationship and file a statement with the Texas Ethics Commission and LCRA, (3) require the registered principal of firms seeking to sell securities to LCRA to: (a) receive and review LCRA's investment policy, (b) acknowledge that reasonable controls and procedures have been implemented to preclude imprudent investment activities, and (c) deliver a written statement attesting to these requirements; (4) in conjunction with its annual financial audit, perform a compliance audit of the management controls on investments and adherence to LCRA's investment policy, (5) restrict reverse repurchase agreements to not more than 90 days and restrict the investment of reverse repurchase agreement funds to no greater than the term of the reverse repurchase agreement, (6) restrict the investment in non-money market mutual funds in the aggregate to no more than 15% of LCRA's monthly average fund balance, excluding bond proceeds and reserves and other funds held for debt service, (7) require local government investment pools to conform to the new disclosure, rating, net asset value, yield calculation, and advisory board requirements and (8) provide specific investment training for the Treasurer, the Chief Financial Officer and the investment officer.

LCRA Board Policy 306 conforms to State law. LCRA values the investment portfolio to market on a monthly basis and the status of the portfolio is presented monthly in the financial report to the LCRA Board. Based upon the most recent valuation of its investments, the market value of LCRA's investment portfolio is currently at or above the portfolio's book value. No funds of LCRA are invested in securities such as collateralized mortgage obligations, obligations commonly referred to as "inverse floaters," or structured notes, which are all commonly referred to as derivative securities.

APPENDIX G

INFORMATION TO BE UPDATED IN ACCORDANCE WITH THE RULE 15c2-12 UNDERTAKING

Annual Financial Statements and Operating Data

The financial information and operating data with respect to LCRA to be provided annually in accordance with "CONTINUING DISCLOSURE OF INFORMATION – Annual Reports" in the Official Statement are as specified (and included in the Appendix or under the headings of the official statement referred to) below:

1. "APPENDIX A - Annual Audited Financial Statements and Annual Supplemental Consolidating Schedules;"
2. "LCRA FINANCIAL POLICIES, BUSINESS PLAN AND CAPITAL BUDGET - Capital Improvements and Incurrence of Additional Indebtedness," the total amount of capital improvements undertaken by LCRA in the most recent completed fiscal year and additionally broken down between the Wholesale Power Services, Water Services and Community Services Business Units;
3. "SELECTED FINANCIAL AND OPERATING INFORMATION - Energy and Sales Statistics," [Table];
4. "SELECTED FINANCIAL AND OPERATING INFORMATION - Selected Financial Information," [Table];
5. "OVERVIEW OF LCRA OPERATIONS - Business Units," the percentage of revenues of LCRA produced by the Wholesale Power Services, Transmission Services, Water Services, Community Services Business Units and the Corporate Services support service, respectively, in the most recent completed fiscal year;
6. "WHOLESALE POWER SERVICES - Generating and Related Facilities - Electric Generation Resources," [Table];
7. "WHOLESALE POWER SERVICES - Generating and Related Facilities - Electric Generation Sources By Category," [Table];
8. "WHOLESALE POWER SERVICES - Generating and Related Facilities - Historic Electric Generation and Demand," [Table];
9. "WHOLESALE POWER SERVICES - Wholesale Electric Customers," the percentage of wholesale electric revenues of LCRA in the most recent completed fiscal year represented by LCRA's three largest wholesale electric customers and the identities of such customers, and the percentage of wholesale electric revenues of LCRA in the most recent completed fiscal year represented by LCRA's ten largest wholesale electric customers;
10. "WHOLESALE POWER SERVICES - Wholesale Power Agreements - General," the percentage of total kilowatt hour sales of LCRA in the most recent completed fiscal year represented by power sales to LCRA's wholesale electric customers and the percentage of revenues of LCRA in the most recent completed fiscal year produced from sales to LCRA's wholesale electric customers;
11. "WATER SERVICES - Hydroelectric Facilities and Dams," the amount of (i) hydroelectric modernization and improvement projects and (ii) dam modernization projects undertaken by LCRA's Water Services

Business Unit in the most recently completed fiscal year and the amount of revenues of LCRA for the most recently completed fiscal year representing sale of water and hydroelectric power;

12. "WATER SERVICES - Regional and Municipal Water and Wastewater Utility Services and Systems," the amount of capital improvements undertaken by LCRA in the most recently completed fiscal year for the Brushy Creek Regional Wastewater System and West Travis County Regional System; and
13. "WATER SERVICES - Capital Improvements," the amount of capital improvements undertaken by LCRA in the most recently completed fiscal year representing water and wastewater utility system projects other than the Brushy Creek Regional Wastewater System and West Travis County Regional System.
14. Audited Financial Statements of TSCorp, so long as TSCorp is an "obligated person" under the Rule.

Accounting Principles

The accounting principles referred to in "CONTINUING DISCLOSURE OF INFORMATION – Annual Reports" in the Official Statement are the accounting principles described in the notes to the financial statements referred to in item 1 above.

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