
BASIC FINANCIAL STATEMENTS

San Antonio Water System
STATEMENT OF NET ASSETS

	December 31	
ASSETS	2004	2003 (Restated)
Current Assets		
Unrestricted Current Assets		
Investments - Note C	\$ 43,542,026	\$ 24,135,583
Accrued interest receivable	1,211,378	1,911,099
Accounts receivable, net of allowance for uncollectable accounts of \$568,848 and \$484,256, respectively	32,036,818	28,115,867
Inventory - materials and supplies	4,537,892	4,858,272
Prepaid expenses and other assets	3,034,787	3,291,681
Total unrestricted current assets	84,362,901	62,312,502
Unamortized Refunding Bond Expenses	10,659,959	9,349,728
Restricted Current Assets:		
Debt Service Fund:		
Cash and cash equivalents - Note C	72,704	-
Construction Funds:		
Cash and cash equivalents - Note C	15,737,966	38,397,197
Conservation:		
Investments - Note C	2,503,665	5,823,169
Other:		
Investments - Note C	-	774,069
Common Stock -Note C	5,819,192	4,707,723
Customers' deposits:		
Investments - Note C	5,952,486	5,627,401
Total restricted current assets	30,086,013	55,329,559
Total Current Assets	125,108,873	126,991,789
Noncurrent Assets		
Restricted Noncurrent Assets:		
Debt Service Fund:		
Investments - Note C	18,784,661	11,467,153
Construction Funds:		
Investments - Note C	205,161,582	235,119,355
Other:		
Investments - Note C	10,194,614	5,605,706
Total restricted noncurrent assets	234,140,857	252,192,214
Assets Held for Resale	8,210,012	8,147,167
Capital Assets:		
Utility plant in service - Note D	2,396,554,145	2,244,550,778
Less allowance for depreciation/amortization	798,456,941	743,691,802
	1,598,097,204	1,500,858,976
Land and land rights - Note D	82,338,637	87,053,949
Construction in progress	509,362,113	428,225,637
Total capital assets (net of accumulated depreciation)	2,189,797,954	2,016,138,562
Total Noncurrent Assets	2,432,148,823	2,276,477,943
TOTAL ASSETS	\$ 2,557,257,696	\$ 2,403,469,732

The accompanying notes to financial statements form an integral part of this statement.

San Antonio Water System
STATEMENT OF NET ASSETS

	December 31	
	<u>2004</u>	<u>2003 (Restated)</u>
LIABILITIES		
Current Liabilities		
Unrestricted Current Liabilities		
Accounts payable	\$ 12,830,586	\$ 12,521,834
Sewer service collections payable	256,013	209,660
Capital leases and notes payable - Note E	627,100	646,762
Accrued vacation payable - Note F	2,816,887	2,936,451
Accrued payroll and benefits	2,539,894	2,151,220
Accrued claims payable - Note F	2,477,402	2,317,236
Accrued stormwater services	1,669,929	32,409
Sundry payables and accruals - Note F	6,049,273	5,270,704
Total unrestricted current liabilities	<u>29,267,084</u>	<u>26,086,276</u>
Restricted Current Liabilities		
Debt Service Fund:		
Accrued interest payable	7,151,404	6,311,042
Construction Funds:		
Contract retainage payable	9,446,172	10,213,434
Advances for construction	1,550,392	933,834
Customers' deposits	5,952,486	5,627,401
Revenue bonds payable within one year - Note G	16,505,000	7,735,000
Total restricted current liabilities	<u>40,605,454</u>	<u>30,820,711</u>
Total Current Liabilities	<u>69,872,538</u>	<u>56,906,987</u>
Noncurrent Liabilities		
Capital leases and notes payable - Note E	1,388,172	2,012,211
Accrued vacation payable - Note F	1,879,465	1,389,582
Commercial paper notes - Note G	238,400,000	269,000,000
Revenue bonds payable after one year - Note G	1,145,905,000	1,040,710,000
Unamortized premium	9,078,394	7,954,777
Less unamortized loss	(22,727,392)	(24,003,866)
Less unamortized discount	(14,382,320)	(13,752,708)
Total Noncurrent Liabilities	<u>1,359,541,319</u>	<u>1,283,309,996</u>
TOTAL LIABILITIES	<u>1,429,413,857</u>	<u>1,340,216,983</u>
NET ASSETS		
Restricted:		
Restricted for debt service fund	11,705,961	5,156,111
Restricted for conservation	2,503,665	5,823,169
Total Restricted	<u>14,209,626</u>	<u>10,979,280</u>
Invested in capital assets, net of related debt	1,041,888,473	972,501,026
Unrestricted	71,745,740	79,772,443
TOTAL NET ASSETS	<u>\$ 1,127,843,839</u>	<u>\$ 1,063,252,749</u>

The accompanying notes to financial statements form an integral part of this statement.

San Antonio Water System
STATEMENT OF REVENUES, EXPENSES
AND CHANGES IN NET ASSETS
For the Years Ended December 31,

OPERATING REVENUES	2004	2003 (Restated)
Water delivery system	\$ 72,888,054	\$ 65,163,910
Water supply system	78,546,461	76,044,416
Wastewater system	99,224,713	87,683,794
Chilled water and steam system	12,027,528	12,193,646
Total operating revenues	262,686,756	241,085,766
 OPERATING EXPENSES		
Personal services	74,416,616	70,792,292
Contractual services	69,126,680	71,084,521
Material and supplies	14,144,227	13,752,939
Other charges	15,474,823	14,869,519
Less: Costs capitalized & transferred to R&R Fund	(19,052,929)	(19,311,806)
Internal service fund - net (gain)/loss	(249,453)	1,555,089
Total operating expenses before depreciation	153,859,964	152,742,554
Depreciation/amortization expense	60,645,869	57,005,400
Total operating expenses	214,505,833	209,747,954
Operating income	48,180,923	31,337,812
 NONOPERATING REVENUES		
Interest earned and miscellaneous	6,703,218	7,187,584
Net increase in the fair value of investments	357,459	121,395
Total nonoperating revenues	7,060,677	7,308,979
 NONOPERATING EXPENSES		
Amortization of refunding bond expense	499,745	430,295
Amortized discount/premium/loss/expense	1,485,132	1,487,573
Other finance charges	1,144,437	1,030,751
Interest expense:		
Revenue bonds and commercial paper	39,933,414	36,973,970
Capital leases and notes payable	174,478	187,896
(Gain)/Loss on sale of capital assets	(131,277)	198,976
Payments to the City of San Antonio	7,101,972	6,607,897
Payments to Greater Kelly Development Authority	184,100	-
Total nonoperating expenses	50,392,001	46,917,358
Increase/(decrease) in net assets, before capital contributions and special items	4,849,599	(8,270,567)
Capital contributions	69,527,611	66,291,578
Special items - Note M	(9,786,120)	-
 CHANGE IN NET ASSETS	 64,591,090	 58,021,011
Net assets, beginning of year (restated) - Note N	1,063,252,749	1,005,231,738
 NET ASSETS, END OF YEAR	 \$ 1,127,843,839	 \$ 1,063,252,749

The accompanying notes to financial statements form an integral part of this statement.

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San Antonio Water System
STATEMENT OF CASH FLOWS
For the years ended December 31,

	2004	2003 (Restated)
CASH FLOWS FROM OPERATING ACTIVITIES		
Cash received from customers	\$ 259,090,890	\$ 239,470,154
Cash paid to vendors for operations	(85,583,074)	(90,848,929)
Cash paid to employees for services	(64,820,555)	(62,266,173)
Net cash provided by operating activities	108,687,261	86,355,052
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Payments to the City of San Antonio	(4,417,485)	(4,673,971)
Payments to Greater Kelly Development Authority	(139,163)	-
Net cash used for noncapital financing activities	(4,556,648)	(4,673,971)
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Proceeds from sale of capital assets	289,065	-
Proceeds from developers for plant construction	24,842,110	14,088,511
Proceeds from commercial paper	-	90,000,000
Proceeds from revenue bonds	119,030,934	153,391,396
Proceeds from grants	829,187	358,267
Payment to employees for construction of plant	(8,837,070)	(7,560,435)
Payment to vendors for construction of plant	(10,427,963)	(11,751,817)
Payments for acquisition of equipment and furniture	(8,079,640)	(8,239,215)
Payments for acquisition of property and plant	(158,433,039)	(212,355,217)
Payment for retirement of commercial paper	(30,600,000)	(76,000,000)
Payment on defeasement on revenue bonds	(7,735,000)	(5,515,000)
Payment of interest on tax exempt commercial paper	(2,805,893)	(5,737,045)
Payment of interest on revenue bonds	(52,204,800)	(44,614,393)
Payment on capital leases	(338,179)	(232,736)
Payment on CPS note	(479,999)	(480,000)
Net cash used for capital and related financing activities	(134,950,287)	(114,647,684)
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of investments	(503,966,635)	(388,799,661)
Maturity of investments	505,626,029	399,158,734
Dividend income	77,539	-
Interest income	6,496,214	6,494,490
Net cash provided by investing activities	8,233,147	16,853,563
NET DECREASE IN CASH AND CASH EQUIVALENTS	(22,586,527)	(16,113,040)
CASH AND CASH EQUIVALENTS, AT BEGINNING OF YEAR	38,397,197	54,510,237
CASH AND CASH EQUIVALENTS, AT END OF PERIOD	\$ 15,810,670	\$ 38,397,197

The accompanying notes to financial statements form an integral part of this statement.

**San Antonio Water System
STATEMENT OF CASH FLOWS
For the Years Ended December 31,**

	2004	2003 (Restated)
RECONCILIATION OF CASH AND CASH EQUIVALENTS PER STATEMENT OF CASH FLOWS TO THE STATEMENT OF NET ASSETS		
Cash and Cash Equivalents		
Restricted		
Debt Service Fund	\$ 72,704	\$ -
Construction Fund	15,737,966	38,397,197
	\$ 15,810,670	\$ 38,397,197
 RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES		
Operating Income	\$ 48,180,923	\$ 31,337,811
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation expense	60,645,869	57,005,400
Change in assets and liabilities:		
(Increase) in accounts receivable	(3,920,951)	(2,246,666)
(Increase)/Decrease in inventory	(490,909)	(335,320)
(Increase)/Decrease in prepaid expenses	256,893	(2,264,944)
Increase in accounts payable	308,751	2,015,992
Increase in amount due for sewer collections	46,353	209,660
Increase in accrued payroll and benefits	388,673	488,878
Increase in accrued vacation payable	370,319	476,805
Increase/(Decrease) in sundry payables and accruals	778,569	(354,890)
Increase/(Decrease) in accrued stormwater services	1,637,520	(1,531,991)
Increase in claims payables	160,166	1,132,922
Increase in customers' deposits	325,085	421,395
Total Adjustments	60,506,338	55,017,241
Net cash provided by operating activities	\$ 108,687,261	\$ 86,355,052

NONCASH INVESTING CAPITAL AND FINANCING ACTIVITIES

The System recorded a non cash payment of \$2,684,487 for the water, reuse, supply and sewer billings to the City of San Antonio.

The System received contributions in the amount of \$45,302,059 from various developers in aid of construction. This amount is recorded as capital contributions.

The net increase in the fair value of investments was \$357,459.

The accompanying notes to financial statements form an integral part of this statement.

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NOTES TO FINANCIAL STATEMENTS

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Reporting Entity: On February 13, 1992, the City Council determined that it was in the best interest of the citizens of San Antonio and the customers served by the water and wastewater systems to consolidate all water systems, agencies and activities into one institution. This action was taken due to the myriad of issues confronting the City related to the development and protection of its water resources. Such consolidation provides the City a singular voice of representation when promoting or defending the City's goals and objectives related to water resource planning and development with local, regional, state and federal water authorities and officials. It was further determined by the Council that the interests of the citizens and customers could best be served by placing authority for management and control of the system, as consolidated, in a board of trustees appointed by the City Council. Additionally, it was determined that the best mechanism for effecting the consolidation of all water systems, agencies and activities into a single institution was through a refunding of all then outstanding water and sewer bonds.

Final Council approval for such consolidation and refunding was given on April 30, 1992 with the approval of Ordinance No. 75686 which effectuated the consolidation of all city owned utilities related to water including the water, wastewater, and water reuse systems as the San Antonio Water System (the "System") through the issuance of Water System Revenue Refunding Bonds, Series 1992. The proceeds of the Series 1992 Bonds were used to defease all outstanding revenue bonds and related long-term debt of the water and wastewater systems.

The pension and retirement plans described in Note K are administered by third parties and are not a part of the reporting entity.

This Comprehensive Annual Financial Report of the System includes no component units. However, the operations of the System as reported herewith are included as a component unit of the City of San Antonio.

Management of the System: The complete management and control of the System has been vested in a board of trustees known as the "San Antonio Water System Board of Trustees." The Board of Trustees consists of the Mayor and six Trustees who must reside within the City of San Antonio or the service area of the System. With the exception of the Mayor all other trustees are appointed by the City Council for four-year staggered terms, however, no person who has served two terms is eligible for reappointment. The Mayor, with the concurrence of the City Council, annually appoints one of the other members of the Board as the Chairman of the Board. In addition to appointment of members of the Board of Trustees, the City Council also has retained authority for approval of requests for rate adjustments, and any sale of additional revenue bonds. The general operations of the System are under the supervision of the President/Chief Executive Officer who is employed by the Board of Trustees. The Board may appoint and employ all officers, employees, and professional consultants, which it may deem desirable.

NOTES TO FINANCIAL STATEMENTS

Annual Budget: Sixty days prior to the beginning of each fiscal year, the System presents, an annual budget prepared on an accrual basis to serve as a tool in controlling and administering the management and operation of the System. The annual budget reflects an estimate of Gross Revenues and the disposition of these revenues in accordance with the flow of funds required by Ordinance No. 75686. (See Note B) The annual budget is submitted to City Council for review and consultation.

Accounting Standards: The System applies all applicable Governmental Accounting Standards Board (GASB) pronouncements as well as any Financial Accounting Standards Board (FASB) statements and interpretations, Auditing Practices Board (APB) opinions and Accounting Research Bulletin's (ARB) issued on or before November 30, 1989 unless those pronouncements conflict with or contradict GASB pronouncements.

Fund Accounting: Within the System's enterprise fund accounts, separate self-balancing funds are maintained to account for resources for various purposes, thereby distinguishing balances restricted by management or outside sources from unrestricted resources. These restrictions are more fully explained in Note B. Interfund receivable and payable accounts have been eliminated in the financial statements.

Funds being designated for conservation are presented by reclassifying assets from unrestricted to restricted. The funds designated for conservation total \$2,503,665 as of December 31, 2004.

Business Segments: System Fund operations are segregated into four core businesses. The System's reporting structure on the four utilities follows:

- Water Supply – the functions related to the development and provision of additional water resources
- Water Delivery – the function of distributing water to the customer
- Wastewater – the functions of collecting and treating wastewater from the user customer
- Chilled Water and Steam – the function related to providing chilled water and steam to specific customers of the System

Basis of Accounting: The financial statements are prepared using the accrual basis of accounting and the flow of economic resources measurement focus. Under this method, revenues are recorded when earned and expenses are recorded at the time liabilities are incurred. Proprietary Funds distinguish operating revenues and expenses from non-operating items. Operating revenues and expenses generally result from providing services in connection with a proprietary fund's principal ongoing operations. The principal operating revenues of the System are charges to customers for water, wastewater, water supply and chilled water and steam services. Operating expenses include the cost of service, administrative expenses and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as non-operating revenues and expenses. When both restricted and unrestricted resources are available for use, it is the System's policy to use restricted first, then unrestricted resources, as they are needed.

NOTES TO FINANCIAL STATEMENTS

Investments: Money Market Investments: Under the provisions of GASB Statement No. 31, money market investment with a remaining maturity at time of purchase of one year or less may be reported at amortized cost, which approximates fair values. The net decrease during fiscal year 2004 in the fair value of the money market investments with an original maturity of greater than one year was \$1.4 million. This amount takes into account all changes in fair value (including purchases and sales) that occurred during the year. The unrealized gain on investments, which includes stock investments, *held* at year-end was \$357,459 .

Accounts Receivable: Accounts receivable totaling \$32.6 million is comprised of four entities within the System as follows: Water Delivery \$10.9 million, Wastewater \$12.1 million, Water Supply \$8.3 million and Chilled Water & Steam \$1.3 . Receivables can be further broken down into water and sewer receivables totaling \$14.5 million; unbilled charges (including water service, water supply, EAA Fees, irrigation, chilled water and steam, sewer and sewer surcharges) totaling \$14.3 million; wholesale entities sewer receivable totaling \$1.8 million and other sundry charges receivable totaling \$2.0 million.

Inventory: Inventories are valued at the lower of average cost or market.

Unamortized Refunding Bond Expense: Expenses relating to the sale of revenue refunding bonds are amortized on a straight-line basis over the life of the issue.

Compensated Absences: It is the policy of the System to accrue employee vacation pay as earned and to accrue an additional amount for its portion of Social Security taxes. Sick leave is not accrued, as a terminating employee is not paid for accumulated sick leave.

Self-Insurance: The System is self-insured for a portion of workers' compensation, employee's health, employer's liability, public officials' liability, property damage, and certain elements of general liability. A liability has been recorded for the estimated amount of eventual loss, which will be incurred on claims arising prior to the end of the period.

Cash Flows Statement: For purposes of the statement of cash flows, the System considers all investments and time deposits with an original maturity of 90 days or less to be cash equivalents.

Capital Assets: Capital assets in service are recorded on the unit cost equal to or greater than \$1,000. Assets acquired through capital leases are recorded on the cost basis and included in utility plant in service. Assets acquired through contributions, such as those from land developers, are capitalized and recorded in the plant accounts at estimated fair market value at date of donation.

NOTES TO FINANCIAL STATEMENTS

It is the policy of the System to capitalize certain interest costs on revenue bonds and commercial paper associated with newly constructed utility plant additions.

Maintenance, repairs, and minor renewals are charged to operating expense; major plant replacements are capitalized. Capital assets are depreciated and property under capital lease is amortized on the straight-line method. This method is applied to all individual assets except distribution mains. Groups of mains are depreciated on the straight-line method using rates estimated to fully depreciate the costs of the asset group over their estimated average useful lives. The table below shows an estimated average of useful lives used in providing for depreciation of capital assets:

Structures and improvements	50 years
Pumping and purification equipment	10 - 50 years
Distribution and transmission system	25 - 50 years
Collection system	50 years
Treatment facilities	25 years
Equipment and machinery	5 - 20 years
Furniture and fixtures	10 years
Computer equipment	5 years
Software	3 years

Capital Contributions: The State of Texas allows the assessment of system development on capital recovery fees that may be used only for additional infrastructure capacity. The System assesses impact fees and has recorded these in the amount of \$24,225,552 and of plant contributions in the amount of \$45,302,059 as capital contributions in 2004.

Estimates: The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

Restatements and Reclassifications: Certain amounts presented in the prior year data have been restated for reasons disclosed in Note N. In addition, other amounts presented in the prior year data have been reclassified in order to be consistent with the current year's presentation.

NOTE B - CITY ORDINANCE NO. 75686

Purpose: On April 30, 1992, City Ordinance No. 75686 was adopted. This ordinance authorized the issuance of \$635,925,000 Water System Revenue Refunding Bonds, Series 1992, dated April 15, 1992. These bonds were issued to refund in advance of maturity \$253,064,519 Water Revenue Bonds authorized and outstanding under terms of City Ordinance No. 52091, \$330,125,000 Sewer Revenue Bonds authorized and outstanding under terms of City Ordinance No. 51975, \$14,500,000 of other bonded debt of annexed water districts, and \$49,200,000 Sewer System Commercial Paper. The purpose of this advance refunding was to release and discharge the covenants contained in City Ordinance No. 52091 and No. 51975 in order to permit the City to consolidate the operations of the water related utilities as stated in Note A.

The System: The System has been defined in City Ordinance No. 75686 as all properties, facilities, and plants currently owned, operated and maintained by the City and/or the Board of Trustees, for the supply, treatment, transmission and distribution of treated potable water, chilled water and steam, for the collection and treatment of wastewater and for water reuse, together with all future extensions, improvements, purchases, repairs, replacements and additions thereto, and any other projects and programs of the System provided, however, that the City retains the right to incorporate a Stormwater System as provided by the Texas Local Government Code.

Funds Flow: City Ordinance No. 75686 requires that Gross Revenues of the System be applied in sequence to: (1) System Fund for payment of current maintenance and operating expenses including a two-month reserve amount based upon the budgeted amount of maintenance and operating expenses for the current Fiscal year; (2) Debt Service Fund requirements of Senior Lien Obligations; (3) Reserve Fund requirements of Senior Lien Obligations; (4) Interest and Sinking Fund and Reserve Fund requirements of Junior Lien Obligations; (5) Interest and Sinking Fund and Reserve Fund requirements of Subordinate Lien Obligations; (6) Payment of amounts required on Inferior Lien Obligations, and (7) Transfers to the City's General Fund and to the Renewal and Replacement Fund.

Reuse Contract: The System has a contract with City Public Service; the city owned electricity and gas utility, for the provision of reuse water. The revenues derived from the contract have been restricted in use to only reuse activities and are excluded from the calculation of Gross Revenue, and are not included in any transfers to the City's General Fund. Revenue derived from this contract was \$2,166,971 during the year ended December 31, 2004.

The System has developed a recycled water system that will provide nonpotable water to various customers now using Edwards Aquifer water. During the year ended in December 31, 2004, the System generated an additional \$2,669,054 in revenue from sales of recycled water. Revenue from recycled water sales is recorded as revenue of the System and has the same restrictions as the reuse contract.

NOTES TO FINANCIAL STATEMENTS

No Free Service: City Ordinance No. 75686 also provides for no free services except for municipal fire-fighting purposes.

NOTE C - DEPOSITS AND INVESTMENTS

City Ordinance No. 75686, the System's Investment Policy, and Texas State law, allow the System to invest in direct obligations of the United States or its agencies and instrumentalities. Other allowable investments include direct obligations of the State of Texas or its agencies and instrumentalities; secured certificates of deposit issued by state and national banks domiciled in the State of Texas; defined bankers acceptances and commercial paper; collateralized direct repurchase agreements; reverse repurchase agreements; no-load money market mutual funds; investment pools; and other types of secured or guaranteed investments. These investments are subject to market risk, interest rate risk, and credit risk and affect the value at which these investments are recorded.

Deposits: All funds of the System are deposited at JP Morgan Chase/Bank One N.A., the System's general depository bank. The System's general depository agreement does not require the system to maintain an average monthly balance. As required by state law, all System deposits are fully collateralized and/or are covered by federal depository insurance. The collateral pledged is being held by the Federal Reserve Bank of New York under the System's name on December 31, 2004. As of December 31, 2004, the bank balance of the System's demand and savings account was \$9,582,614 and the reported amount was \$7,404,211, which includes \$191,353 of cash on hand.

Investments: All investments of the System, with the exception of those held in escrow, are in securities of the U.S. Treasury or Agencies of the United States and are held in safekeeping by the System's general depository bank, JP Morgan Chase/Bank One N.A., registered as accounts of the System. Funds held in escrow, are Money Market Funds managed by Wachovia Bank and JP Morgan Chase/Bank One and are invested in U.S. Treasury Obligations.

As of December 31, 2004, the System had the following investments and maturities:

Investment Type	Fair Value	Investment Maturities (in Days)				Reported Amount
		Less Than 90	91 to 180	181 to 365	Greater Than 365	
U.S. Treasury Bills	\$ 27,876,083	\$ 6,395,782	\$ 13,295,421	\$ 8,184,880	\$ -	\$ 27,892,405
U.S. Treasury Notes	69,734,758	-	5,539,825	50,835,488	13,359,445	69,852,710
U.S. Agency Discount Notes	91,994,191	-	4,874,501	87,119,690	-	92,125,632
U.S. Agency Coupon Notes	93,796,372	-	2,936,413	23,273,256	67,586,703	93,871,887
Money Market Funds held in Escrow:						
Wachovia Bank	7,876,911	7,876,911	-	-	-	7,876,911
JP Morgan Chase/Bank One	2,925,948	2,925,948	-	-	-	2,925,948
	<u>\$ 294,204,263</u>	<u>\$ 17,198,641</u>	<u>\$ 26,646,160</u>	<u>\$ 169,413,313</u>	<u>\$ 80,946,148</u>	<u>\$ 294,545,493</u>

NOTES TO FINANCIAL STATEMENTS

Interest Rate Risk. As a means of limiting its exposure to fair value losses due to rising interest rates, the System's investment policy limits its investment maturities to no more than five years. Currently, more than half (73%) of the System's investment portfolio is invested in maturities less than one year. Investment maturities are as follows:

<u>Maturity</u>	<u>Percent of Portfolio</u>
Zero to 90 days	6%
91 to 180 days	9%
181 to 365 days	58%
More than one year	27%

Credit Risk. The goal of the System's investment policy is to manage its exposure to credit risk by limiting its fixed income investments to a rating of "A" or better. The System's investments in government sponsored entities such as Federal Home Loan Bank, Federal National Mortgage Association, Federal Home Loan Mortgage Corporation and Federal Farm Credit Bank were rated Aaa by Moody's Investors Service and AAA by Standard & Poor's and Fitch Ratings. The investments in money market funds were rated Aaa by Moody's Investor Service and AAA by Standard & Poor's.

Concentration of Credit Risk. There are no restrictions in the System's investment policy on the amount it may invest in any one issuer. Therefore, the System has invested more than five percent of its investments in government sponsored entities, in the form of discount or coupon notes. The following reflects the percentage amount invested in each issuer as a percent of the total portfolio:

Federal Home Loan Bank	13.61%
Federal National Mortgage Association	9.96%
Federal Home Loan Mortgage Corporation	37.75%

Pay-Fixed, Receive-Variable Interest Rate Swap

Objective of the Interest Rate Swap. On March 27, 2003 the System entered into an interest rate swap agreement in connection with its City of San Antonio, Texas Water System Subordinate Lien Revenue and Refunding Bonds, Series 2003-A and 2003-B ("the Series 2003 Bonds") issued in a variable interest rate mode. The Series 2003 Bonds were issued to provide funds for the System's Capital Improvements Program and to refund certain outstanding commercial paper notes. The swap was used to hedge interest rates on the Series 2003 Bonds to a synthetic fixed rate that produced a lower expected interest rate cost to the System than traditional long term fixed rate bonds.

NOTES TO FINANCIAL STATEMENTS

Terms, fair values, and credit risk. The terms, including the counterparty credit ratings of the outstanding swap, as of December 31, 2004, are included in the table below. The System's swap agreement contains scheduled reductions to the outstanding notional amounts that are expected to follow scheduled reductions in the associated bonds. The Series 2003 Bonds were issued on March 27, 2003 with a principal amount of \$122,500,000. The swap was structured to match the principal amortization structure and dates of the Series 2003 Bonds. The counterparty to the swap is Bear Stearns Financial Products, Inc. ("Bear Stearns").

Related Bonds	Maturity	Counterparty	CP Rating by Moody's/S&P/Fitch	Variable Rate Received	Fixed Rate Paid	Market Value
Series 2003 Bonds	May 1, 2033	Bear Stearns	Aaa/AAA/AAA	BMA	4.18%	\$(3,124,871)

The combination of variable rate bonds and a floating-to-fixed swap creates a synthetic fixed-rate issue for the System. The synthetic fixed-rate protects against the potential of rising interest rates in conjunction with the System's Series 2003 Bonds issued in a weekly mode and achieves a lower fixed rate than in the traditional fixed rate bond market at the time of issuance.

Fair Value. The swap had a negative fair value as of December 31, 2004 of \$(3,124,871). This value was calculated using the zero-coupon method. This method calculates the future net settlement payments required by the swap, assuming that the current forward rates implied by the yield curve correctly anticipated future spot interest rates. These net payments are then discounted using the spot rates implied by the current yield curve for hypothetical zero-coupon bonds due on the date of each future net settlement on the swap.

Credit Risk. As of December 31, 2004, the System was not exposed to credit risk on its outstanding swap because the swap had a negative fair value. However, should interest rates change and the fair value of the swap become positive, the System would be exposed to credit risk in the amount of the swap's fair value. The swap counterparty, Bear Stearns, was rated AAA by Fitch Ratings and Standard & Poor's and Aaa by Moody's Investors Services as of December 31, 2004. The swap agreement contains a collateral agreement with the counterparty. Collateralization of the fair value of the swap is required should Bear Stearns credit rating fall below the applicable thresholds in the agreement.

Basis risk. The System is exposed to basis risk to the extent that the interest payments on its variable-rate bonds do not match the variable-rate payments received on the associated swap. The System mitigates this risk by (a) matching the notional amount and amortization schedule of the swap to the principal amount and amortization schedule of the Series 2003 Bonds, and (b) selecting an index for the variable-rate leg of the swap that is reasonably expected to closely match the interest rate resets on the Series 2003 Bonds over the life of the issue.

Termination Risk. The System may terminate for any reason. Bear Stearns may terminate a swap if the System fails to perform under the terms of the agreement. The System's ongoing payment obligations under the swap are insured, and Bear Stearns cannot terminate as long as the insurer does not fail to perform. If the swap should be terminated, the Series 2003 Bonds would no longer carry synthetic fixed interest rates. Also, if at the time of the termination the swap has a negative fair value, the System would be liable to the counterparty for a payment equal to the swap's fair value.

Swap payments and associated debt. As of December 31, 2004, debt service requirements of the variable-rate debt and net swap payments, assuming current interest rates remain the same are below. As rates vary, variable-rate bond interest payments and net swap payments will vary.

**Pay-Fixed, Receive-Variable Interest Rate Swap:
Estimated Debt Service Requirements of Variable-Rate
Debt Outstanding and Net Swap Payments**

Year	Variable-Rate Bonds		Interest Rate Swap, Net	Total
	Principal	Interest		
2005	\$ 2,080,000	\$ 2,334,915	\$ 2,608,911	\$ 7,023,826
2006	2,170,000	2,292,971	2,562,045	7,025,016
2007	2,275,000	2,249,067	2,512,989	7,037,056
2008	2,375,000	2,203,171	2,461,706	7,039,877
2009	2,485,000	2,155,183	2,408,088	7,048,271
2010 - 2014	14,235,000	9,975,420	11,146,005	35,356,425
2015 - 2019	17,780,000	8,401,475	9,387,362	35,568,837
2020 - 2024	22,220,000	6,434,909	7,190,026	35,844,934
2025 - 2029	27,770,000	3,976,677	4,443,328	36,190,004
2030 - 2033	27,125,000	1,004,239	1,122,083	29,251,322
Total	<u>\$ 120,515,000</u>	<u>\$ 41,028,027</u>	<u>\$ 45,842,540</u>	<u>\$ 207,385,567</u>

Stock Investment: The demutualization of Metropolitan Life Insurance on April 7, 2000 made the System, a policyholder, eligible to receive compensation for the membership interest for the dental plan provided as a benefit for employees. The demutualization compensation consisted of a distribution of 7,567 shares of MetLife, Inc. Common Stock. On the date of issue, the stock was priced at \$14.25 per share for a total value to the System of \$107,830.

On October 26, 2001, with the demutualization of Principal Financial Group, Inc. the System received compensation for the membership interest for the life insurance provided as a benefit for employees and retirees. The demutualization compensation consisted of a distribution of 134,652 shares of Principal Financial Group, Inc. Common Stock. On the date of issuance, the stock was priced at \$23.35 per share for a total value to the System of \$3,144,124.

NOTES TO FINANCIAL STATEMENTS

These two stock transactions have been recorded on the System's financial records as of December 31, 2004. In accordance with GASB 31, an unrealized gain has been recorded in the amount of \$1,059,711 for Principal Financial Group, Inc. and \$51,758 for MetLife, Inc. as reflected in the table below.

<u>Principal Financial Group, Inc (PFG)</u>		<u>Stock Value</u>		<u>Gain/(Loss)</u>
Issuance Date:	12/10/2001			
Number of Shares	134,652			
Historical Cost:	\$ 23.35	\$ 3,144,124	\$ 3,144,124	\$ 3,144,124
Stock Price 12/31/2003	33.07	4,452,942		1,308,818
Stock Price 12/31/2004	40.94	5,512,653		1,059,711
<u>MetLife, Inc (MET)</u>				
Issuance Date:	4/7/2000			
Number of Shares:	7,567			
Historical Cost:	\$ 14.25	\$ 107,830	\$ 107,830	\$ 107,830
Stock Price 12/31/2003	33.67	254,781		146,951
Stock Price 12/31/2004	40.51	306,539		51,758
Total Gain/(Loss)				

The following is a reconciliation of deposits and investments from the note to the statement of net assets:

Reported Amounts from Notes as presented above		
Deposits		\$ 7,404,211
Investments		294,545,493
Common Stock:		
PFG		5,512,653
MET		306,539
		<u>\$ 307,768,896</u>
Totals from Statement of Net Assets:		
Restricted - Cash and Cash Equivalents		
Construction Funds		\$ 15,737,966
Debt Service Fund		72,704
Investments		
Unrestricted		43,542,026
Restricted:		
Debt Service Fund		18,784,661
Construction Funds		205,161,582
Common Stock		5,819,192
Other Restricted		10,194,614
Customer Deposits		5,952,486
Conservation		2,503,665
Investments		<u>291,958,226</u>
Total Cash, Cash Equivalents and Investments		<u>\$ 307,768,896</u>

NOTES TO FINANCIAL STATEMENTS

NOTE D – CAPITAL ASSETS IN SERVICE

	December 31, 2003 (Restated)	Increases	Transfers	Decreases	December 31, 2004
Capital Assets, not being depreciated:					
Land	\$ 68,976,930	\$ 8,814,849	\$ (9,788)	\$ 14,245,051	\$ 63,536,941
Acquisition of Water Rights	18,077,019	724,680	-	-	18,801,699
Construction in Progress	428,225,637	224,216,062	-	143,079,587	509,362,113
Total capital assets, not being depreciated	515,279,586	233,755,590	(9,788)	157,324,638	591,700,753
Capital assets, being depreciated/amortized:					
Structures and improvements	251,595,913	39,666,396	-	-	291,262,309
Pumping and purification equipment	46,936,042	12,130,200	(765,475)	119,223	58,181,543
Distribution and transmission system	873,001,075	44,937,004	(42,449)	1,124,305	916,771,326
Treatment facilities	973,782,115	52,830,146	691,585	16,548	1,027,287,298
Equipment and machinery	76,504,366	5,345,701	150,526	2,893,549	79,107,044
Furniture and fixtures	3,432,803	48,327	-	12,521	3,468,609
Computer equipment	13,486,014	2,273,878	(24,399)	1,717,017	14,018,476
Software	5,812,451	1,028,779	-	383,691	6,457,539
Total capital assets being depreciated/amortized	2,244,550,779	158,260,432	9,788	6,266,854	2,396,554,145
Less accumulated depreciation/amortization for:					
Structures and improvements	(58,053,687)	(5,348,672)	-	-	(63,402,359)
Pumping and purification equipment	(12,866,561)	(941,747)	-	-	(13,808,308)
Distribution and transmission system	(256,396,877)	(21,238,141)	51	(1,124,303)	(276,510,664)
Treatment facilities	(356,276,285)	(25,563,400)	(51)	(6,509)	(381,833,226)
Equipment and machinery	(43,945,815)	(4,886,927)	-	(2,716,206)	(46,116,536)
Furniture and fixtures	(2,057,314)	(359,366)	-	(11,401)	(2,405,279)
Computer equipment	(8,692,837)	(1,912,932)	-	(1,638,596)	(8,967,154)
Software	(5,402,426)	(394,682)	-	(383,691)	(5,413,416)
Total accumulated depreciation/amortization	(743,691,802)	(60,645,868)	-	(5,880,706)	(798,456,943)
Total capital assets, being depreciated/amortized net	1,500,858,977	97,614,564	9,788	386,148	1,598,097,202
Capital assets, net	\$ 2,016,138,563	\$ 331,370,154	\$ -	\$ 157,710,785	\$ 2,189,797,954

NOTES TO FINANCIAL STATEMENTS

NOTE E – Leases/Notes Payable

Capital Leases: The System entered into various lease agreements for financing the acquisition of computer equipment and heavy equipment. These lease agreements meet the requirements of a capital lease for accounting purposes and, therefore, are recorded at the present value of the future minimum lease payments as of the inception date. The annual percentage rates of the leases range from 5.5% to 7.5%. At the end of the respective lease terms, the ownership of the equipment transfers to the System or the System has the option to purchase the equipment. The following is a summary of changes in lease obligations for the year ended December 31, 2004.

Balance December 31, 2003	\$	581,212
Less:Principal Payments		<u>308,155</u>
Balance December 31, 2004	\$	<u><u>273,057</u></u>

The future minimum lease obligations and the present value of these minimum lease payments as of December 31, 2004 are as follows:

<u>Years Ending</u> <u>December 31,</u>	<u>Present Value of</u> <u>Minimum Lease Payments</u>	<u>Interest</u>	<u>Total</u> <u>Minimum Lease Payments</u>
2005	\$ 265,504	\$ 10,640	\$ 276,144
2006	<u>7,553</u>	<u>175</u>	<u>7,728</u>
Total	<u><u>\$ 273,057</u></u>	<u><u>\$ 10,815</u></u>	<u><u>\$ 283,872</u></u>

Operating Leases: The System leases building and office facilities under non-cancelable operating leases. Total costs for such leases were \$149,240 for the year ended December 31, 2004. The future minimum lease payments are as follows:

NOTES TO FINANCIAL STATEMENTS

<u>Years Ending December 31,</u>	<u>Amount</u>
2005	\$ 149,240
2006	149,240
2007	149,240
2008	37,310
Total	<u>\$ 485,030</u>

CPS Note Payable: During fiscal year 2000, a contract was entered into between the System and City Public Service Board of San Antonio (CPS) whereby the System acquired water rights valued at \$3,592,678 from certain CPS owned properties. A note was signed for 116 payments of \$40,000 at an interest rate of 7.5%. Total payments on this note are \$4,640,000 including interest. The liability as of December 31, 2004 is reflected on the balance sheet for both the current portion of \$361,596 and long-term amount of \$1,380,619. The following is a summary of changes in CPS Note Payable for the year ended December 31, 2004 and the payments due in future years:

Balance December 31, 2003	\$ 2,077,761
Less:Principal Payments	<u>335,546</u>
Balance December 31, 2004	<u>\$ 1,742,215</u>

CPS NOTE PAYABLE			
<u>Years Ending December 31,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total Requirements</u>
2005	\$ 361,596	\$ 118,404	\$ 480,000
2006	389,668	90,332	480,000
2007	419,918	60,082	480,000
2008	452,518	27,482	480,000
2009	<u>118,515</u>	<u>1,485</u>	<u>120,000</u>
Total	<u>\$ 1,742,215</u>	<u>\$ 297,785</u>	<u>\$ 2,040,000</u>

NOTES TO FINANCIAL STATEMENTS

NOTE F – OTHER LIABILITIES

Accrued Vacation Payable: The System records an accrual for vacation payable for all full time employees and pays unused vacation hours available at the end of employment with the final paycheck. The accrued vacation payable recorded at December 31, 2004 is \$4,696,352 with \$2,816,887 estimated as a current liability.

Year Ended	Balance at Beginning of Fiscal-Year Liability	Current-Year Accruals	Payments	Balance at Fiscal Year-End Liability	Estimated Due Within One Year
December 31, 2003	\$ 3,849,228	\$ 3,413,256	\$ (2,936,451)	\$ 4,326,032	\$ 2,936,451
December 31, 2004	\$ 4,326,032	\$ 3,187,207	\$ (2,816,887)	\$ 4,696,352	\$ 2,816,887

Sundry Payable and Accruals: The System has sundry payables and accruals totaling \$6,049,273 as shown in the table below.

Sundry payables and accruals	
Account Description	Amount
Accrued Ordinance Payments to City	\$ 448,044
Employee Insurance Payable	2,259,390
Miscellaneous Accruals	2,791,597
Unclaimed Property	91,490
Unearned Accruals	296,429
Other Payables	162,323
	<u>\$ 6,049,273</u>

Risk Management: The System 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. The System is self administered and self-insured for the first \$500,000 of each worker's compensation and general liability, automobile liability and public official's liability and \$250,000 for pollution legal liability claim. Claims that exceed the self-insured retention limit are covered through the System's comprehensive commercial insurance program. For the year ended December 31, 2004, there were no reductions in insurance coverage from the previous year and there were no claims that exceeded the self-insured retention limit. Settled claims have not exceeded the insurance coverage in any of the past three fiscal years. The System has recorded an accrued claims liability in the amount of \$2,477,402 as of December 31, 2004, which is reported as a current liability of the System. The claims liability, including incurred but not reported claims, is based on the estimated ultimate cost of

NOTES TO FINANCIAL STATEMENTS

settling the claims. The claims liability includes medical and rehabilitation costs, which are considered incremental claim adjustment expenses. Changes in the liability amount for the last two fiscal years were:

Year Ended	Balance at Beginning of Fiscal-Year Liability	Current-Year Accruals	Payments	Balance at Fiscal Year-End Liability	Estimated Due Within One Year
December 31, 2003	\$ 1,184,314	\$ 3,028,644	\$ (1,895,722)	\$ 2,317,236	\$ 2,317,236
December 31, 2004	\$ 2,317,236	\$ 1,674,745	\$ (1,514,579)	\$ 2,477,402	\$ 2,477,402

NOTE G – LONG TERM DEBT

REVENUE BONDS

On June 30, 2004, the System issued \$84,700,000 City of San Antonio, Texas Water System Revenue and Refunding Bonds, Series 2004. The proceeds from the sale of the Bonds were used to (i) provide funds for the purpose of acquiring, purchasing, constructing, improving, renovating, enlarging, and equipping the System, (ii) refund \$5 million in outstanding commercial paper notes, and (iii) pay the cost of issuing the bonds. The bonds are secured together with other outstanding Senior Lien Obligations solely by a lien on and pledge of net revenues.

On July 7, 2004, the System issued \$10,635,000 City of San Antonio, Texas Water System Junior Lien Revenue and Refunding Bonds, Series 2004 with the Texas Water Development Board. The Bonds were sold under the Federal Cross Cutter Program with interest rates ranging from 0.00% - 3.20%. The proceeds from the sale of the bonds were used to (i) finance capital improvement projects which qualify under the Texas Water Development Board Program (ii) refund \$4.8 million in outstanding commercial paper notes, and (iii) pay the cost of issuance. The bonds are secured together with other currently outstanding Junior Lien Obligations solely by a lien on a pledge of net revenues and are subordinate to outstanding Senior Lien Obligations.

On July 7, 2004, the System issued \$26,365,000 City of San Antonio, Texas Water System Junior Lien Revenue and Refunding Bonds, Series 2004-A with the Texas Water Development Board. The bonds were sold under the State Revolving Fund (SRF) Program, with interest rates ranging from 0.75% - 4.20%. The proceeds from the sale of the bonds were used to (i) finance capital improvement projects which qualify under the Texas Water Development Board Program, (ii) refund \$20.8 million in outstanding commercial paper notes, and (iii) pay the cost of issuance. The bonds are secured together with other currently outstanding Junior Lien Obligations solely by a lien on a pledge of net revenues and are subordinate to outstanding Senior Lien Obligations.

NOTES TO FINANCIAL STATEMENTS

All three issues resulted in the conversion of debt from short-term to long-term. As a result there was no economic gain or loss associated with the refunding.

Senior Lien Water System Revenue Bonds, comprised of Series 1996, Series 1997, Series 1999, Series 2001, Series 2002, Series 2002-A, and Series 2004, outstanding in the amounts of \$822,860,000 at December 31, 2004, are collateralized by a senior lien and pledge of the Gross Revenues of the System after deducting and paying the current expenses of operation and maintenance of the System and maintaining an operating reserve for operating and maintenance expenses. At December 31, 2004 these bonds are due in varying amounts, from a low of \$5,275,000 in 2033 to a high of \$62,485,000 in 2028.

Junior Lien Water System Revenue Bonds, comprised of Series 1999, Series 1999-A, Series 2001, Series 2001-A, Series 2002, Series 2002-A, Series 2003, Series 2004, and Series 2004-A outstanding in the amount of \$219,035,000 at December 31, 2004, are collateralized by a junior lien and pledge of the Gross Revenues of the System after deducting and paying the current expenses of operation and maintenance of the System maintaining an operating reserve for operating and maintenance expenses, and debt service on senior lien debt. At December 31, 2004 the Junior Lien bonds are due in varying amounts, from a low of \$3,120,000 in 2024 to a high of \$17,885,000 in 2019.

Subordinate Lien Water System Revenue Bonds, comprised of Series 2003-A and 2003-B, outstanding in the amount of \$120,515,000 at December 31, 2004, are collateralized by a subordinate lien and pledge of the Gross Revenues of the System after deducting and paying the current expenses of operation and maintenance of the System maintaining an operating reserve for operating and maintenance expenses, and debt service on senior lien and junior lien debt. At December 31, 2004 the Subordinate Lien bonds are due in varying amounts, from a low of \$2,080,000 in 2005 to a high of \$7,240,000 in 2033.

Revenue bonds currently outstanding are as follows:

<u>Purpose</u>	<u>Interest Rates</u>	<u>Amount</u>
Build, improve, extend, enlarge, and repair the System	0.00-6.25%	\$1,162,410,000

NOTES TO FINANCIAL STATEMENTS

The following summarizes transactions of the revenue bonds for the year ended December 31, 2004.

	Beginning Balance Jan. 1, 2004	Additions	Reductions	Ending Balance Dec. 31, 2004	Due Within One Year
Bonds Payable	\$ 1,048,445,000	\$ 121,700,000	\$ 7,735,000	\$ 1,162,410,000	\$ 16,505,000
Less Deferred Amounts: For issuance discounts/ premiums/losses	\$ (29,801,798)	\$ 285,347	\$ 1,485,133	\$ (28,031,318)	\$ -
Total Bonds Payable, Net	<u>\$ 1,018,643,202</u>	<u>\$ 121,985,347</u>	<u>\$ 9,220,133</u>	<u>\$ 1,134,378,683</u>	<u>\$ 16,505,000</u>

<u>Year Ended December 31,</u>	<u>Annual Debt Service Requirements Revenue Bonds</u>					
	<u>Subordinate Lien Revenue and Refunding Bonds</u>		<u>Junior Lien Revenue and Refunding Bonds</u>		<u>Senior Lien Revenue and Refunding Bonds</u>	
	<u>Principal</u>	<u>Interest</u>	<u>Principal</u>	<u>Interest</u>	<u>Principal</u>	<u>Interest</u>
2005	\$ 2,080,000	\$ 5,037,527	\$ 4,945,000	\$ 7,406,869	\$ 9,480,000	\$ 42,807,372
2006	2,170,000	4,950,583	5,100,000	7,246,839	15,145,000	42,178,046
2007	2,275,000	4,859,877	7,850,000	7,044,554	14,755,000	41,361,058
2008	2,375,000	4,764,782	8,085,000	6,796,559	18,705,000	40,474,533
2009	2,485,000	4,665,507	10,285,000	6,519,607	19,585,000	39,476,501
2010 - 2014	14,235,000	21,670,792	67,130,000	26,781,945	105,095,000	181,823,773
2015 - 2019	17,780,000	18,412,900	80,430,000	14,046,399	132,650,000	149,684,836
2020 - 2024	22,220,000	14,342,625	35,210,000	2,597,682	216,980,000	104,316,237
2025 - 2029	27,770,000	9,254,729	-	-	240,050,000	39,407,957
2030 - 2034	27,125,000	2,897,576	-	-	50,415,000	5,289,578
	<u>\$120,515,000</u>	<u>\$90,856,898</u>	<u>\$ 219,035,000</u>	<u>\$ 78,440,454</u>	<u>\$ 822,860,000</u>	<u>\$ 686,819,891</u>

NOTES TO FINANCIAL STATEMENTS

Debt Covenants: The System is required to comply with various provisions included in the ordinances, which authorized the bond issuances. The System is in compliance with all significant provisions of the ordinances.

Prior Year of Defeasance of Debt: In prior years, the System defeased certain revenue bonds by placing revenues or proceeds of new bond issues in an irrevocable trust to provide for all future debt service payments on the old bonds. Accordingly, the trust account assets and liability for the defeased bonds are not included in the System's financial statements. At December 31, 2004, \$46,155,000 of bonds outstanding are considered defeased.

COMMERCIAL PAPER PROGRAM

The System maintains a Commercial Paper Program that is used to provide funds for the interim financing of a portion of capital improvements to the System.

On January 11, 2001, the City Council of the City of San Antonio approved the expansion of the TECP Program (Tax Exempt Commercial Paper) from \$175 million to \$350 million. The increase in the program provides interim financing for the increased level of future expenditures on water resource projects. Notes payable under the program cannot exceed maturities of 270 days and scheduled maturities of the short-term borrowing under the Commercial Paper Program may not extend past May 14, 2032.

The City has covenanted in the Ordinance authorizing the Commercial Paper Program (the "Note Ordinance") to maintain at all times credit facilities with banks or other financial institutions, which would provide available borrowing sufficient to pay the principal of the Commercial Paper Program. The credit facility is maintained under the terms of a revolving credit agreement.

The issuance of the Notes is further supported by the following agreements and related participates:

- Dealer Agreements with Goldman, Sachs & Co., J.P. Morgan Securities Inc., and Ramirez & Co., Inc.
- Revolving Credit Agreement with Bank of America, N.A.
- Issuing and Paying Agency Agreement with JPMorgan Trust Company, National Association.

The borrowings under the Commercial Paper Program are equally and ratably secured by and are payable from (i) the proceeds from the sale of bonds or additional borrowing under the Commercial Paper Program and (ii) borrowing under and pursuant to the revolving credit agreement.

Commercial paper notes of \$238,400,000 are outstanding as of December 31, 2004. The proceeds of the notes have been used solely for financing of capital improvements of the System. The tax exempt commercial paper notes have been classified as long-term in accordance with the refinancing terms of the Credit Agreement and since management intends to continue the remarketing of the tax exempt commercial paper notes to maintain a

NOTES TO FINANCIAL STATEMENTS

portion of its debt in variable rates. Interest rates on the notes outstanding at year- end range from 1.70% to 1.90% and from 34 to 96 days in maturity. (The outstanding notes at December 31, 2004 had an average rate of 1.80% and averaged 67 days to maturity.)

The following summarizes transactions of the commercial paper program for the year ended December 31, 2004.

	Beginning Balance Jan. 1, 2004	Additions	Reductions	Ending Balance Dec. 31, 2004
Commercial Paper Notes	\$ 269,000,000	\$ -	\$ 30,600,000	\$ 238,400,000

NOTE H - CONTINGENCIES AND COMMITMENTS

The System is the subject of various claims and litigation, which have risen in the ordinary course of its operations. Management, in consultation with legal counsel, is of the opinion that the System's liabilities in these cases, if decided adversely to the System, will not be material.

The System is committed under various contracts for completion of construction or acquisition of utility plant totaling approximately \$182.44 million as of December 31, 2004. Funding of this amount will come from available revenues of the System, contributions from developers, and restricted assets.

NOTE I - CAPITALIZED INTEREST COSTS

Interest costs incurred on revenue bonds and commercial paper totaled \$55,851,055 during the year ended December 31, 2004 of which \$15,917,641 was capitalized as part of the cost of the System's utility plant additions.

NOTE J - STORMWATER PROGRAM

The Stormwater Program is a federally mandated program, under the Environmental Protection Agency, for the monitoring of the quality and quantity of pollution found in rain runoff.

The City of San Antonio and the System have administrative responsibility for the Stormwater Program and have entered into an interlocal agreement, which establishes the entities' respective responsibilities. The System's responsibility is in various aspects of data collection and analysis related to the water quality of Stormwater and responsibility for customer billings and collection. Costs incurred by the System related to the Stormwater Program are reflected as expenses and are reimbursed by the City.

NOTES TO FINANCIAL STATEMENTS

The following information provides a summary of the operations of the Stormwater Program.

	<u>December 31, 2004</u>
Operating Revenue	\$ 2,746,327
Operating Expenses	<u>3,097,367</u>
Revenues over (under) Expenses	<u>\$ (351,040)</u>

As defined in City Ordinance No. 75686, the Stormwater Program is not considered a part of the “System” and as such, revenues generated by the Stormwater Program are used to pay expenses of the Stormwater Program but are not available for debt service of the System or for transfer to the City of San Antonio.

NOTE K - PENSION AND RETIREMENT PLANS

The System's retirement program includes benefits provided by Texas Municipal Retirement System, a contract with Principal Life Insurance Company, and Social Security.

Covered employees are eligible to retire upon attaining the normal retirement age of 65. An employee may elect early retirement, with reduced benefits, upon attainment of,

- 1. 20 Years of credited service regardless of age, or
- 2. 5 years of credited service and at least age 60.

The normal retirement benefit is based upon two factors, average compensation and years of credited service. Average Compensation is defined as the monthly average of total compensation received for the three consecutive years ending December 31, out of the last ten compensation years prior to normal retirement date which gives the highest average. The normal retirement benefit under the Principal contract is equal to:

- 1. 1.2% of the Average Compensation, times years of credited service not in excess of 25 years, plus
- 2. 0.75% of the Average Compensation, times years of credited service in excess of 25 years but not in excess of 35 years, plus
- 3. 0.375% of the Average Compensation, times years of credited service in excess of 35 years.

Upon retirement, an employee must select from one of seven alternative payment plans. Each payment plan

NOTES TO FINANCIAL STATEMENTS

provides for monthly payments as long as the retired employee lives. The options available address how plan benefits are to be distributed to the designated beneficiary of the retired employee. The program also provides death and disability benefits.

The following information related to the Texas Municipal Retirement System was prepared as of December 31, 2003 and Principal Life Insurance has been prepared as of January 1, 2004.

Texas Municipal Retirement System

The Texas Municipal Retirement System (TMRS) was established in 1948 as a retirement and disability pension system for municipal employees in the State of Texas. It is administered in accordance with the Texas Municipal Retirement System Act (the Act), Subtitle G of Title 110B, Revised Civil Statutes of Texas, 1925 as amended, and is governed by a Board of Directors appointed by the Governor of Texas in accordance with the Act. TMRS issues a publicly available financial report that includes financial information related to participating municipalities. The report may be obtained by writing to:

TMRS, P.O. Box 149153, Austin, Texas 78714-9153 or calling (512) 476-7577.

Plan Description: The System provides pension benefits for all of its full-time employees through a nontraditional, joint contributory, hybrid defined benefit plan in the state-wide Texas Municipal Retirement System (TMRS), one of 794 administered by TMRS, an agent multiple-employer public employee retirement system.

Benefits depend upon the sum of the employee's contributions to the plan, with interest, and the System- financed monetary credits, with interest. At the date the plan began, the System granted monetary credits for service rendered before the plan began of a theoretical amount equal to two times what would have been contributed by the employee, with interest, prior to the establishment of the plan. Monetary credits for service since the plan began are a percentage (100%, 150%, 200%) of the employee's accumulated contributions. In addition, the System can grant as often as annually another type of monetary credit referred to as an updated service credit which is a theoretical amount that when added to the employee's accumulated contributions and the monetary credits for service since the plan began, would be the total monetary credits and employee contributions accumulated with interest if the current employee contribution rate and System matching percent had always been in existence and if the employee's salary had always been the average of his salary in the last three years that are one year before the effective date. At retirement, the benefit is calculated as if the sum of the employee's accumulated contributions with interest and the employer-financed monetary credits with interest were used to purchase an annuity.

Members can retire at ages 60 and above with 5 or more years of service or with 20 years of service regardless of age. A member is vested after 5 years. The plan provisions are adopted by the System within the options available in the state statutes governing TMRS and within the actuarial constraints also in the statutes.

NOTES TO FINANCIAL STATEMENTS

Contributions: The contribution rate for the employees is 3% of salary. The System's matching percent ratio is currently 1 to 1, as adopted by the System. Under the state law governing TMRS, the actuary annually determines the System contribution rate. This rate consists of the normal cost contribution rate and the prior service cost contribution rate, both of which are calculated to be a level percent of payroll from year to year. The normal cost contribution rate finances the currently accruing monetary credits due to the System matching percent, which are the obligation of the System as of an employee's retirement date, not at the time the employee's contributions are made. The normal cost contribution rate is the actuarially determined percent of payroll necessary to satisfy the obligation of the System to each employee at the time his/her retirement becomes effective. The prior service contribution rate amortizes the unfunded/(overfunded) actuarial liability/(asset) over the remainder of the plan's 25-year amortization period.

The unit credit actuarial cost method is used for determining the System contribution rate. Both the employees and the System make contributions monthly. Since the System needs to know its contribution rate in advance for budgetary purposes, there is a one-year delay between the actuarial valuation that is the basis of the rate and the calendar year when the rate goes into effect (i.e. December 31, 2003 valuation is effective for rates beginning January 2004.)

Year	Annual Required Contribution (ARC)	Annual Pension Cost (APC)	Percentage of APC Contributed	NPO Balance
2002	\$ 1,771,692	\$ 1,771,692	100%	\$ -
2003	\$ 1,904,671	\$ 1,904,671	100%	\$ -
2004	\$ 2,012,732	\$ 2,012,732	100%	\$ -

Required Three- Year Trend Information:

The Schedules of Funding Progress for the last three fiscal years as required under GASB Statement No. 27 are located in the "Required Supplementary Information" section of this report. The Schedules are designed to provide information about the System's progress in accumulating sufficient assets to pay benefits due.

Texas Municipal Retirement System			
Schedule of Contributions			
	<u>2004</u>	<u>2003</u>	<u>2002</u>
Employer Contribution	\$ 2,012,732	\$ 1,904,671	\$ 1,771,692
Employee Contribution	1,829,799	1,736,196	1,645,536
Employer Contribution Rate	3.30%	3.29%	3.24%

Texas Municipal Retirement System	
Actuarial Assumptions	
Actuarial Cost Method	Unit Credit
Amortization Method	Level Percent of Payroll
Remaining Amortization	25 Years - Open Period
Asset Valuation Method	Amortized Cost
Investment Rate of Return	7%
Projected Salary Increases	None
Includes Inflation At	None
Cost of Living Adjustments	None

Principal Life Insurance

Plan Description: The San Antonio Water System Pension Plan is a single-employer defined benefit pension plan controlled by the provisions of Ordinance No. 75686, which serves as a supplement to the TMRS and Social Security benefits. The plan is governed by the System which may amend plan provisions and which is responsible for the management of plan assets. The System has delegated the authority to manage certain plan assets to Principal Life Insurance Company. The System's covered payroll for employees at January 1, 2004 under this contract was \$56,931,548

The System provides supplemental pension benefits for all persons customarily employed at least 20 hours per week and five months per year through this defined benefit pension plan. Employees are eligible to participate in the plan on January 1 of the calendar year following date of hire. The plan allows an employee to accrue vesting benefits as follows:

Principal Life Insurance	
<u>Years of Service</u>	<u>Vested Percentage</u>
Less than 5	0%
5 or More	100%

An employee is automatically 100% vested upon attainment of age 65 or upon becoming totally and permanently disabled. Benefits for retired employees are fully guaranteed at retirement. The pension plans unallocated insurance contracts are valued at contract value. Contract value represents contributions made under the contract, plus interest at the contract rate, less funds used to purchase annuities or pay administrative expense charged by Principal Life Insurance Company. Funds under the contract that have been allocated and applied to purchase annuities are excluded from the pension plan's assets. The Pension Plan's unallocated separate accounts are valued at fair value.

Actuarially Determined Contribution Requirements and Contributions Made: The plan's funding policy provides for actuarially determined periodic contributions so that sufficient assets will be available to pay benefits when due. The actuarial cost method is known as the Entry Age Normal-Frozen Initial Liability Method. This method estimates the total cost of the projected pension benefits for each employee evenly from the date the employee is first eligible for the plan to the employee's assumed retirement age. As plan benefits are related to compensation, the cost is spread as a level percentage of compensation. The total of annual amounts for all employees combined is called the Normal Cost. The employee's Entry Age is determined as if the plan had always been in existence. As of the plan effective date, there are some accumulated Normal Costs for past years that have not been paid. The value of these costs is called the Frozen Initial Liability.

In subsequent years the Frozen Initial Liability is reduced by employer deposits to the plan in excess of employer Normal Cost and interest requirements. This reduced amount is known as the Unfunded Frozen Initial Liability. Contribution requirements are established and maybe amended by the System. Active members are not required to contribute to the plan. Any obligation with respect to the pension plan shall be paid by the System. The actuarial valuation, which was performed for the plan year ended December 31, 2003, reflects an unfunded frozen initial liability of \$10,643,941

The Principal Life Insurance Pension Plan Calculation of Net Pension Obligation (NPO)					
Plan Year	Annual Required Contribution (ARC)	Annual Pension Cost (APC)	Percentage of APC Contributed	NPO Balance	
2002	\$ 2,856,916	\$ 2,856,916	100%	\$	-
2003	\$ 3,323,862	\$ 3,323,862	100%	\$	-
2004	\$ 3,485,618	\$ 3,485,618	100%	\$	-

If the Normal Cost or Un-funded Frozen Liability becomes negative through the normal operation of the plan, the un-funded Frozen Liability will be reestablished using the Entry Age Normal method. If the reestablishment would result in a negative Normal Cost or Un-funded Frozen Liability, the method will be changed to the aggregate method. If the actuarial value of assets exceeds the total present value of benefits, the Aggregate Normal Cost will be zero. Then the Frozen Initial Liability will be reestablished when a positive Entry Age Normal un-funded liability results from a change in assumptions or a plan amendment.

Principal Life Insurance Actuarial Assumptions	
Actuarial Cost Method	Entry Age Normal - Frozen Initial Liability Period
Amortization Method	Level Dollar
Remaining Amortization Period	36 Years - Closed Period
Asset Valuation Method	Amortized Cost
Investment Rate of Return	8.25%
Inflation Rate	None
Salary Scale	Table S-5 from the Actuary's Pension Handbook plus 3.4%
Cost of Living Adjustments	None
Wage base increase	4% each year until retirement
Post Employment Benefits	None

Required Three-Year Trend Information: The schedule of funding progress for the last three fiscal years are required under GASB Statement No. 27 and are located in the “Required Supplementary Information” section of this report. The schedules are designed to provide information about the system’s progress in accumulating sufficient assets to pay benefits due.

NOTES TO FINANCIAL STATEMENTS

The Pension Fund issues a publicly available financial report that includes financial statements and required supplemental information. That report may be obtained by writing to: Principal Life Insurance Company, Pension Diversified Retirement Services, Des Moines, Iowa 50392-0001 or by calling (515) 247-5111.

NOTE L - OTHER POST EMPLOYMENT BENEFITS

In addition to providing pension benefits described in Note K, the System provides certain health care and life insurance benefits for retired employees. Substantially all full-time employees who retire from the System may become eligible for those benefits. On December 31, 2004 there were 468 retirees with life insurance and 480 retirees with medical coverage.

The System provides medical and life insurance for retirees and recognizes the cost of providing these benefits on a pay-as-you-go basis by expensing the annual insurance. Premiums for medical and life insurance amounted to \$4,023,545 and \$76,286 respectively for January 1, 2004 through December 31, 2004. Medical benefits are provided to retiree and active employees through a self-insured health plan administered by Blue Cross Blue Shield of Texas. Other similar benefits for active employees are provided through insurance companies.

NOTE M – SPECIAL ITEMS

During the annual inventory count, \$811,289 of inventory was written off. This included \$466,950 of obsolete inventory and \$344,339 due to inventory shrinkage.

In 2004 the System reached an agreement with the City of San Antonio for property exchanges. Land known as Applewhite property that had a historical cost of \$14,244,842 was exchanged for easements and other consideration in the amount of \$2,049,611. The exchange resulted in a loss to the System in the amount of \$12,195,231.

Land known as La Semana property was exchanged for water rights and other consideration and resulted in a gain of \$3,220,400.

The net effect to gain and loss for the inventory write-off and the property exchanges resulted in a loss to the System of \$9,786,120.

NOTES TO FINANCIAL STATEMENTS

NOTE N – RESTATED NET ASSETS

Prior year net assets have been restated due to a reclass of 2002 stock dividends in the amount of \$95,997, settlement payment for a bankruptcy case in the amount of \$6,500, recording of a prior year payroll expense in the amount of \$25,965, recording of stock received from Principal Life and MetLife in the amount of \$4,707,723, and the correction of the capital assets beginning balance in the amount of \$295,521.

Balance, December 31, 2003 as previously reported	\$ 1,058,185,972
Reclass 2002 and 2003 Stock Dividend	95,997
Settlement Payment for Bankruptcy Case	(6,500)
Payroll expense	(25,965)
Record Stocks received and gain(loss) on fair value	4,707,723
Correction of the capital assets beginning balance	<u>295,521</u>
Balance, December 31, 2003 as restated	<u><u>\$ 1,063,252,748</u></u>