ELECTRIC POWER BOARD OF THE METROPOLITAN GOVERNMENT OF NASHVILLE AND DAVIDSON COUNTY

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

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CROSSLIN & ASSOCIATES
CERTIFIED PUBLIC ACCOUNTANTS

INDEPENDENT AUDITORS' REPORT

Members of the Electric Power Board of the
Metropolitan Government of
Nashville and Davidson County
Nashville, Tennessee

We have audited the accompanying statements of net assets of the Electric Power Board of the Metropolitan Government of Nashville and Davidson County (the "Board"), a component unit of the Metropolitan Government of Nashville and Davidson County, Tennessee, as of June 30, 2008 and 2007, and the related statements of revenues, expenses and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of the Board'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 examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

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

As described in Note 8 to the financial statements, the Board adopted the provisions of GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, which changed its method of accounting for postemployment benefits effective for the year ended June 30, 2008.

The management's discussion and analysis as listed in the accompanying table of contents 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.

Crosslin & Associates, P.C.

Nashville, Tennessee
October 23, 2008

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MANAGEMENT'S DISCUSSION AND ANALYSIS

As financial management of the Electric Power Board of the Metropolitan Government of Nashville and Davidson County (the "Board"), we offer readers of these financial statements this narrative overview and analysis of the financial activities of the Board for the fiscal years ended June 30, 2008 and 2007 as compared to fiscal years 2007 and 2006, respectively. In conducting the operations of the electrical distribution system, the Board does business as Nashville Electric Service ("NES"). NES is a component unit of the Metropolitan Government of Nashville and Davidson County, Tennessee. This discussion and analysis is designed to assist the reader in focusing on the significant financial issues and activities and to identify any significant changes in financial position. We encourage readers to consider the information presented here in conjunction with the financial statements taken as a whole.

Overview of the Financial Statements

This discussion and analysis is intended to serve as an introduction to NES' financial statements, which are comprised of the basic financial statements and the notes to the financial statements. Since NES is comprised of a single enterprise fund, no fund-level financial statements are shown.

Basic Financial Statements

The basic financial statements are designed to provide readers with a broad overview of NES' finances in a manner similar to that of a private-sector business.

The statements of net assets present information on all of NES' assets and liabilities, with the difference between the two reported as net assets. Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial position of NES is improving or deteriorating. Net assets increase when revenues exceed expenses. Increases to assets without a corresponding increase to liabilities results in increased net assets, which indicates an improved financial position.

The statements of revenues, expenses, and changes in net assets present information showing how NES' net assets changed during the fiscal year. All changes in net assets are reported as soon as the underlying event occurs, regardless of timing of related cash flows. Thus, revenues and expenses are reported for some items that will only result in cash flows in future fiscal periods (e.g., earned but unused vacation leave).

The statements of cash flows present changes in cash and cash equivalents resulting from operating, financing, and investing activities. These statements present cash receipts and cash disbursements information, without consideration as to the timing for the earnings event, when an obligation arises, or depreciation of capital assets.

Summary of Changes in Net Assets

Assets exceeded liabilities by $472.1 million at June 30, 2008 and $438.6 million at June 30, 2007. This represents an increase of $33.5 million in 2008 and $44.0 million for 2007. All of those increases are attributable to operations and interest.

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)

The largest portion of the Board's net assets reflects its investment in capital assets less any related debt used to acquire those assets that is still outstanding. The Board uses these capital assets to provide service and consequently, these assets are not available to liquidate liabilities or for other spending.

An additional portion of the Board's net assets represents resources that are subject to external restrictions on how they may be used. These restrictions include bond proceeds to be used for construction projects and reserve funds required by bond covenants.

STATEMENTS OF NET ASSETS ($000 omitted)

	June 30,		
	2008	**2007**	**2006**
ASSETS			
CURRENT ASSETS	$ 231,887	$ 213,612	$ 188,344
INVESTMENT OF RESTRICTED FUNDS	150,776	47,892	78,967
UTILITY PLANT, NET	775,019	742,333	703,763
ENERGY CONSERVATION PROGRAMS' NOTES	550	789	1,153
OTHER NON-CURRENT ASSETS	3,300	2,703	2,989
TOTAL ASSETS	1,161,532	1,007,329	975,216
LIABILITIES			
CURRENT LIABILITIES	144,773	120,326	119,305
CURRENT LIABILITIES PAYABLE FROM RESTRICTED ASSETS	16,635	16,525	15,960
LONG-TERM DEBT	524,099	428,091	441,340
OTHER NON-CURRENT LIABILITIES			
Payable to TVA – energy conservation programs	550	789	1,153
Other	3,376	2,978	2,839
	3,926	3,767	3,992
COMMITMENTS AND CONTINGENCIES			
TOTAL LIABILITIES	689,433	568,709	580,597
NET ASSETS			
Invested in capital assets, net of related debt	339,793	302,464	284,013
Restricted	48,265	45,532	44,026
Unrestricted	84,041	90,624	66,580
TOTAL NET ASSETS	$ 472,099	$ 438,620	$ 394,619

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)

Liquidity and Capital Resources

On June 27, 2008, the Board closed on the sale of the Metropolitan Government of Nashville and Davidson County, Tennessee, Electric System Revenue Bonds, 2008 Series A and B. The purpose of the 2008 Series A Bonds was to reimburse NES for a portion of the 2008 capital expenditures and to fund approximately 50 percent of NES' projected $218.9 million Capital Budget for the fiscal years ending June 30, 2009, through June 30, 2011. The remainder will be funded with operating revenues. The par amount of the 2008 Series A Bonds, $109.2 million, plus original issue premium, less underwriter discount, cost of issuance, and a deposit to the debt service reserve fund netted proceeds in the amount of $111.8 million of which $110 million was deposited into the Special Construction Fund, $1.6 million in the Debt Service Reserve Fund and $225 thousand into the General Fund. The proceeds in the Special Construction Fund will be drawn down quarterly over the next three years. The 2008 Series B Bonds were being offered to refund $74,430,000 aggregate principal amount of the 1998 Series A Bonds maturing May 15, 2015, 2016 and 2023, and to refund $13,240,000 aggregate principal amount of 1998 Series B Bonds maturing on May 15, 2009, 2010 and 2011. The Board believes it has sufficient debt capacity and a strong financial position. Therefore, the tax-exempt bond market is expected to be a future source of liquidity to supplement the cash flow from operations.

The Board's ongoing sources of liquidity are operating cash flow and proceeds from tax-exempt bonds. During fiscal year 2008, NES drew down $32.7 million from the Construction Fund, which represented the final proceeds from the 2004 Series A, Electric System Revenue Bonds. The Board, as a matter of practice, funds approximately 50 percent of the capital budget with the proceeds from tax-exempt bonds. The remainder is funded with operating revenues.

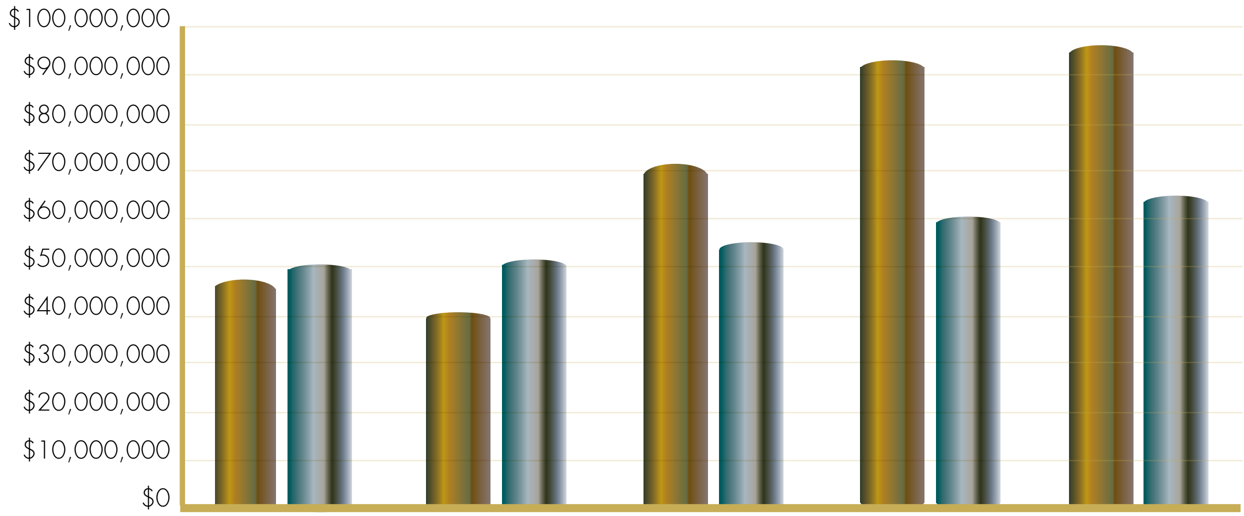
In addition to operating cash flow and proceeds from tax-exempt bonds, the Board has a $25 million line of credit, which is renewed each year. The credit facility is not a source of liquidity for ongoing operations. It is available as an additional funding source in the event of a natural catastrophe.

During the fiscal year ended June 30, 2008, the Board's revenue bonds are rated at Aa, AA+, and AA by Moody's, Standard & Poor's, and Fitch, respectively. In issuing bond ratings, agencies typically evaluate financial operations, rate-setting practices, and debt ratios. Higher ratings aid in securing favorable borrowing rates, which results in lower interest costs.

In order to maintain its strong credit ratings, the Board has adopted certain financial goals. Such goals provide a signal to the Board as to the adequacy of rates for funding ongoing cash flows from operations. One such goal is a cash goal of 7 percent of in-lieu-of-tax payments, purchased power, and operating and maintenance expenses. That goal was met every month of the fiscal year 2008. That percentage was 10.1 percent as of June 30, 2008, and 10.8 percent as of June 30, 2007.

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)

COMPARISON OF CASH BALANCES TO NES' GOALS



	2004	2005	2006	2007	2008
Cash	$47,722,000	$40,672,000	$71,797,000	$93,157,000	$94,776,000
Goal	$50,914,000	$51,168,000	$56,928,000	$60,648,000	$65,758,000

Operations

Summary Revenue & Expense Data ($000 omitted)

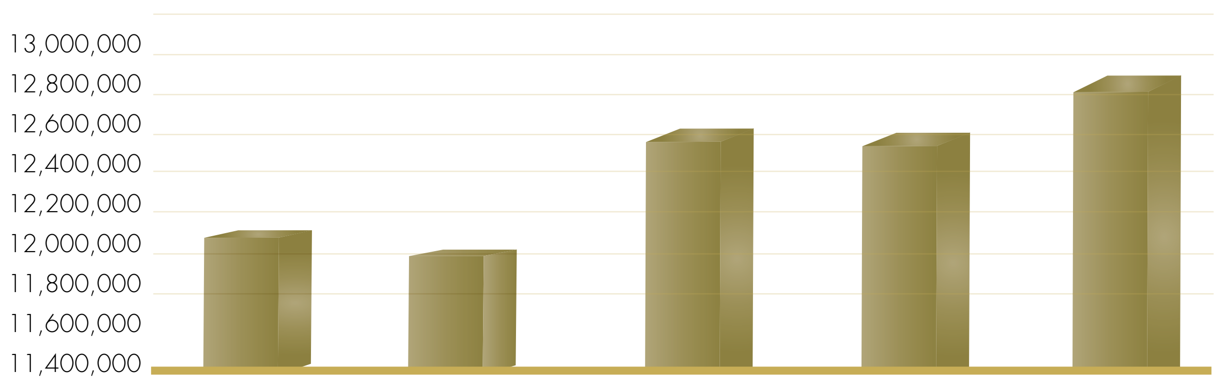
	Year Ended June 30, 2008	Year Ended June 30, 2007	Net Asset Effect	Year Ended June 30, 2006	Net Asset Effect
Operating Revenues	$1,030,953	$962,828	$ 68,125	$903,455	$ 59,373
Purchased Power	794,786	733,735	(61,051)	686,639	(47,096)
Margin	236,167	229,093	7,074	216,816	12,277
Operating Expenses	119,835	107,433	(12,402)	102,550	(4,883)
Depreciation and Taxes	65,659	62,242	(3,417)	60,026	(2,216)
Interest Income	5,736	8,788	(3,052)	4,322	4,466
Interest Expense	22,930	24,205	1,275	24,234	29
Increase in Net Assets	$ 33,479	$ 44,001	$ (10,522)	$ 34,328	$ 9,673

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)

2008 and 2007 Results of Operations

Operating Revenues. Operating revenues increased by $68.1 million, or 7.1 percent, when compared to 2007. Total electric sales were $1.0 billion for the period versus $945.8 million last year. The average realized rate on electric sales was $.0794 per kilowatt-hour in 2008 compared to $.0756 per kilowatt-hour in 2007. The increase in average realized rates in 2008 is the impact of TVA rate adjustments for fuel and the wholesale rate increase that was effective in April 2008. Megawatt-hours sold in 2008 increased by 2.1 percent when compared to 2007. In April 2008, TVA increased wholesale rates 7.0 percent, which increased retail rates by 5.4 percent. TVA also implemented a quarterly Fuel Cost Adjustment (FCA) on all firm energy effective October 2006. The wholesale rate increase and quarterly FCA were implemented as a pass-through to our retail customers. Since the increase in wholesale rates and fluctuations in the wholesale FCA were matched by corresponding adjustments in retail rates, there was no direct impact on NES net income. Management feels that there will be sufficient resources to meet all our objectives until fiscal year 2010 without requiring additional rate increases. However, any rate action by TVA would likely be passed along to the customer. Weather plays an important part in determining revenue for any year. The impact of weather is reflected in the comparison of degree-days from one period to the next. Degree-days represent the difference between the weather's average daily temperatures minus 65 degrees. Temperatures above 65 degrees are considered cooling degree-days; temperatures below 65 degrees are considered heating degree-days. Total cooling degree-days were 2,164 compared to 2,020 in 2007. Total heating degree-days were 3,320 compared to 3,248 in 2007. Total heating and cooling degree-days were 5,484 compared to 5,268 in 2007 or an increase of approximately 4 percent. Total average number of active year-to-date customers increased by 1.7 percent when compared to 2007.

MEGAWATT-HOURS SOLD



	2004	2005	2006	2007	2008
Megawatt-Hours Sold	12,162,000	11,925,000	12,589,000	12,543,000	12,806,000

Non-operating Revenues. Interest Income was $5.7 million compared to $8.8 million in 2007. The average rate of return on the General Fund was 3.82 percent in 2008 compared to 5.40 percent in 2007. The average monthly balance of the General Fund was $101.2 million in 2008 compared to $86 million in 2007, an increase of 17.7 percent. Revenue in Excess of Net Bills (Late Charge) increased by $0.1 million, and Rentals of Electric Property (primarily pole attachments) increased by $0.1 million.

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)

Operating Expenses. The Board purchases all of its power from TVA under an all-requirements contract that had an initial term of 20 years. Beginning on December 19, 1989, and on each subsequent anniversary thereafter, the contract is automatically extended for an additional one year. The contract is subject to earlier termination by either party on not less than 10 years' prior written notice. Purchased power was $794.8 million for the period compared to $733.7 million last year. The average realized rate on purchased power was $.060 per kilowatt-hour in 2008 compared to $.0565 per kilowatt-hour in 2007. This increase is due to the pass-through of the FCA and the impact of TVA wholesale rate increases. Megawatt-hours purchased were 13.2 million in 2008 compared to 13.0 million in 2007. Line losses were 3.2 percent in 2008 compared to 3.3 percent in 2007, or a decrease of 2.4 percent.

Distribution expense for the period was $46.1 million compared to $44.0 million last year. This is an increase of $2.1 million or 4.8 percent. The change is primarily attributable to increases in miscellaneous expenses of $0.8 million; operation and maintenance of meters of $0.6 million; operation and maintenance of overhead lines of $0.6 million; operation and maintenance of underground lines of $0.6 million; storms of $0.6 million; and line transformers of $0.2 million, offset by a decrease in tree-trimming of $1.3 million.

Customer Accounts expense and Customer Service and Information expenses combined were $19.5 million for the period compared to $18.4 million last year or an increase of $1.1 million or 6.0 percent. This is primarily the result of an increase in the uncollectible accounts accrual of $0.9 million and customer orders and service expense of $0.8 million, offset by a decrease in customer records and collection of $0.5 million.

Administrative and General (A&G) expenses were $54.2 million for the period compared to $45.0 million last year. This was an increase of $9.2 million or 20.4 percent. The increase is primarily the result of an increase in employee health insurance of $8.0 million, administrative and general salaries, $0.6 million; and injuries and damages of $0.6 million. The increase in employee health insurance is due to the annual required contribution for NES' post-retirement benefits other than pensions, which is the result from implementation of GASB Statement No. 45.

Depreciation and Tax Equivalents were $40.9 million and $24.8 million compared to $37.0 million and $25.2 million for 2008 and 2007, respectively. The increase in depreciation was the result of increased investment in the utility plant. Tax equivalents consist primarily of payments in-lieu-of taxes to the Metropolitan Government and the surrounding counties. Such payments are calculated based on a prescribed formula that takes into consideration utility plant value and the average of the Board's last three years' operating margin. The decrease in in-lieu-of taxes payments was the result of increases in tax rates and investment in the utility plant offset by changes in equalization factors.

2007 and 2006 Results of Operations

Operating Revenues. Operating revenues increased by $59.4 million, or 6.6 percent, when compared to 2006. Total electric sales were $945.8 million for the period versus $887.0 million in the previous year. The average realized rate on electric sales was $.0756 per kilowatt-hour in 2007 compared to $.0705 per kilowatt-hour in 2006. Megawatt-hours sold in 2007 decreased by 0.4 percent when compared to 2006. In October 2006, TVA reduced wholesale rates 4.5 percent, which reduced retail rates by 3.4 percent. TVA also implemented a quarterly Fuel Cost Adjustment (FCA) on all firm energy effective October 2006. The wholesale rate reduction and quarterly FCA were implemented as a pass-through to our retail customers. Since the reduction in wholesale rates and fluctuations in the wholesale FCA were matched by corresponding adjustments in retail rates, there was no direct impact on NES net income. Weather plays an important part in determining revenue for any year. The impact of weather is reflected in the comparison of degree-days from one period to the next. Degree-days represent the difference between the weather's average daily temperatures minus 65 degrees. Temperatures above 65 degrees are considered cooling degree-days; temperatures below 65 degrees are considered heating degree-days. Total cooling degree-days were 2,020

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)

compared to 2,022 in 2006. Total heating degree-days were 3,248 compared to 3,321 in 2006. Total heating and cooling degree-days were 5,268 compared to 5,343 in 2006 or a decrease of approximately 1 percent. Total average number of active year-to-date customers increased by 1.6 percent when compared to 2006.

Non-operating and Other Revenues. Interest Income was $8.8 million compared to $4.3 million in 2006. The average rate of return on the General Fund was 5.4 percent in 2007 compared to 4.4 percent in 2006. The average monthly balance of the General Fund was $86 million in 2007 compared to $58 million in 2006, which represents an increase of 48 percent. Revenue in Excess of Net Bills (Late Charges) increased by $0.3 million, and Rentals of Electric Property (primarily pole attachments) increased by $0.4 million.

Operating Expenses. The Board purchases all of its power from TVA under an all-requirements contract that had an initial term of 20 years. Beginning on December 19, 1989, and on each subsequent anniversary thereafter, the contract is automatically extended for an additional one-year term. The contract is subject to earlier termination by either party on not less than 10 years' prior written notice. Purchased power was $733.7 million for the period compared to $686.6 million in 2006. The average realized rate on purchased power was $.0565 per kilowatt-hour in 2007 compared to $.0530 per kilowatt-hour in 2006. Megawatt-hours purchased were 13.0 million in 2007 compared to 12.9 million in 2006. Line losses were 3.3 percent in 2007 compared to 2.6 percent in 2006, or an increase of 28.9 percent.

Distribution expense for the period was $44.0 million compared to $42.3 million in 2006. This is an increase of $1.7 million or 4.0 percent. The change is primarily attributable to increases in operation and maintenance of station equipment of $1.1 million and miscellaneous of $1.0 million.

Customer Accounts expense and Customer Service and Information expenses combined were $18.4 million for the period compared to $18.0 million in 2006 or an increase of $0.4 million or 2.2 percent. This is primarily the result of an increase in the customer orders and service expense of $0.5 million and data processing of $0.3 million, offset by a decrease in customer assistance of $0.3 million.

Administrative and General (A&G) expenses were $45.0 million for the period compared to $42.2 million in 2006. This was an increase of $2.8 million or 6.6 percent. The increase is primarily the result of an increase in employee pensions of $1.3 million, administrative and general salaries of $0.4 million; maintenance of general plant of $0.3 million, and office supplies and expenses of $0.3 million.

Depreciation and Tax Equivalents were $37.0 million and $25.2 million compared to $36.0 million and $24.1 million for 2007 and 2006, respectively. The increase in depreciation was the result of increased investment in the utility plant. Tax equivalents consist primarily of payments in–lieu-of taxes to the Metropolitan Government and the surrounding counties. Such payments are calculated based on a prescribed formula that takes into consideration utility plant value and the average of the Board's last three years' operating margin. The increase in payments in-lieu-of taxes was the result of increases in tax rates coupled with increased investment in the utility plant.

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)

The following table shows the composition of the operating expenses of the Board by major classification of expense for the last three years:

Major Classifications of Expense ($000 Omitted)

Description	Fiscal 2008	Fiscal 2007	Increase (Decrease)	Fiscal 2006	Increase (Decrease)
Labor, excluding overtime	$ 45,249	$ 41,569	8.9%	$ 40,006	3.9%
Benefits	32,159	24,522	31.1%	23,870	2.7%
Tree-trimming	9,097	9,818	(7.3%)	11,166	(12.1%)
Outside Services	8,177	7,555	8.2%	6,258	20.7%
Materials	4,609	4,370	5.5%	4,266	2.4%
Transportation	3,690	3,498	5.5%	3,161	10.7%
Accrual for Uncollectible Accounts	2,946	2,200	33.9%	2,100	4.8%
Postage	1,532	1,518	0.9%	1,559	(2.6%)
Security/Police	909	866	5.0%	850	1.9%
Rentals	961	872	10.2%	867	0.6%
Professional Fees	1,054	923	14.2%	737	25.2%
Insurance Premiums	664	755	(12.1%)	653	15.6%
Other	8,788	8,967	(2.0%)	7,057	27.1%
	$119,835	$107,433	11.5%	$102,550	4.8%

The Board's total operating expenses increased by 11.5 percent from June 30, 2007, to June 30, 2008. Labor costs increased primarily due to step increases and merit raises. The total number of employees remained around 1,000. Tree-trimming decreased due to this being the third year of retrimming areas that were initially trimmed three years ago. The increase in Outside Services is primarily due to the pole-pulling program. Material costs were more than last year due to more maintenance projects being completed. Transportation costs increased as more operational and maintenance work was completed and the cost of maintaining and operating vehicles increased. Accrual for Uncollectible Accounts increased as a result of additional write-offs. Professional fees were more primarily due to an increase in legal fees of $167,000 and strategic plan consulting of $80,000.

The Board's total operating expenses increased 4.8 percent from June 30, 2006, to June 30, 2007. Labor costs increased primarily due to step increases and merit raises. The total number of employees remained below 1,000. Tree-trimming decreased due to this being the second year of retrimming areas that were initially trimmed in the first three-year trimming cycle. Outside services increased partially due to a full year of the pole treatment and inspection program. Material costs were more than last year due to more maintenance projects being completed. Transportation costs increased as more operational and maintenance work was completed and the cost of maintaining and operating vehicles increased. The Other category contains a wide array of smaller accounts. The primary reason for the variance in that category is the result of a credit adjustment for reimbursements from TEMA and FEMA in the previous year that were not received in the current year. There was also an increase in Professional Fees of $250,000 due to the use of more legal services during the fiscal year.

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)

Budgetary Highlights

The Board approves an Operating and Capital Budget each fiscal year. The operating budget remains in effect the entire year and is not revised except to adjust for rate changes.

	Year Ended June 30, 2008 ($000 omitted)		
	Budget	Actual	Over (Under)
Operating Revenues	$ 1,021,954	$ 1,030,953	$ 8,999
Purchased Power	788,163	794,786	6,623
Margin	233,791	236,167	2,376
Operating Expenses	123,277	119,835	(3,442)
Depreciation and Taxes	66,613	65,659	(954)
Interest Income	9,148	5,736	(3,412)
Interest Expense	28,670	22,930	(5,740)
Increase in Net Assets	$ 24,379	$ 33,479	$ 9,100
Capital Expenditures	$ 74,546	$ 75,532	$ (986)

The Board's increase in net assets was $9.1 million over its budget of $24.4 million. The increase over budget results from the actual margin and expenses being more favorable than budgeted. Interest income was less than budgeted due to unfavorable market activity and depletion of the Construction Fund during the previous fiscal year. The major contributors to the variance in operating expenses from budget were favorable variances in medical of approximately $0.6 million, retirement and survivors expenses of $0.6 million, and tree-trimming of $1.7 million.

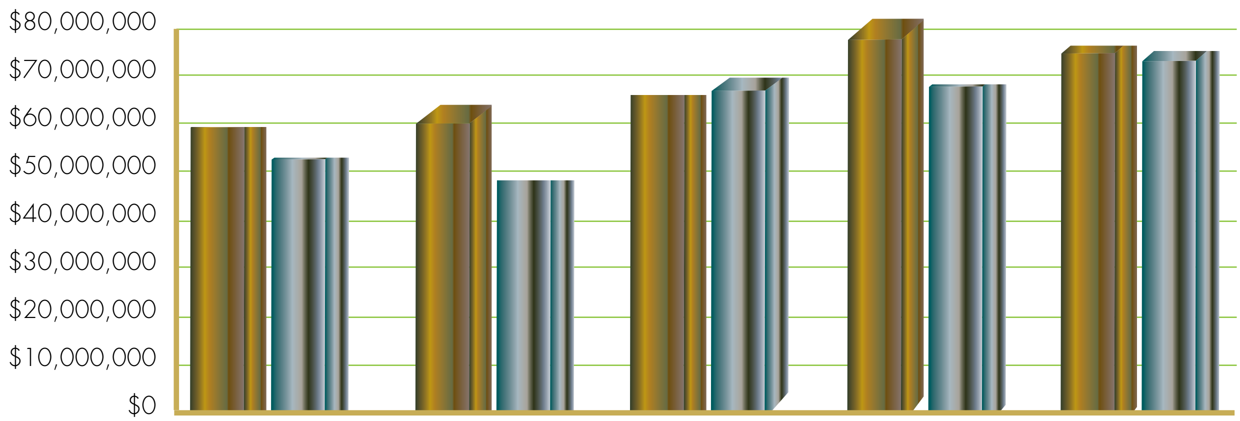
Interest Income and Interest Expense are less than budgeted as a result of a delay in the timing of the issuance of the 2008 Series A and B Revenue Bonds.

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)

	Year Ended June 30, 2007 ($000 omitted) Budget	Actual	Over (Under)
Operating Revenues	$963,290	$962,828	$(462)
Purchased Power	738,671	733,735	(4,936)
Margin	224,619	229,093	4,474
Operating Expenses	108,369	107,433	(936)
Depreciation and Taxes	63,516	62,242	(1,274)
Interest Income	6,345	8,788	2,443
Interest Expense	23,555	24,205	650
Increase in Net Assets	$ 35,524	$ 44,001	$ 8,477
Capital Expenditures	$ 68,300	$ 77,255	$ 8,955

The Board's increase in net assets was $8.5 million over its budget of $35.5 million for fiscal 2007. More than half of the increase over budget results from the actual margin being more favorable than budgeted. Interest income was also greater than budgeted due to higher interest rates earned during the fiscal year. The major contributors to the variance in operating expenses from budget were favorable variances in medical of approximately $1 million and tree-trimming of $1.2 million.

CAPITAL PROGRAM



	2004	2005	2006	2007	2008
Actual	$57,086,000	$59,184,000	$65,936,000	$77,255,000	$75,532,000
Budget	$52,575,000	$58,778,000	$66,837,000	$68,300,000	$74,546,000

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)

The 2008 Capital Budget was $74.5 million; $75.5 million was spent. This budget variance is primarily due to expenses associated with serving new and expanding customer load.

The 2007 Capital Budget was $68.3 million; $77.3 million was spent. This budget variance is primarily associated with an increase in the inventory of transformers and a rise in commodity prices for materials used to manufacture transformers.

Capital Assets and Debt Administration

The Board's transmission and distribution facilities serve all of the 533 square miles located within the boundaries of the Metropolitan Government of Nashville and Davidson County, Tennessee. The Board serves an additional 167 square miles located in minor portions of the adjacent counties of Cheatham, Rutherford, Robertson, Sumner, Wilson, and Williamson. Such facilities require significant annual capital and maintenance expenditures. The Board's target is to have the capital expenditures funded equally from cash flow from operations and proceeds from tax-exempt bonds. The Board's investment in utility plant at June 30, 2008, was $775.0 million compared to $742.3 million at June 30, 2007. Major projects during fiscal year 2008 included the Forest Hills substation that was energized during this fiscal year. The total cost of that project was $10.6 million. The installation of a substation breaker was completed at Elysian Fields substation, which totaled $1.8 million. The Finn Street substation was upgraded with a total cost of $850,000. Various distribution system improvements were completed, including 4kV conversions at Hayes Street and Division Street, with a cost of $1.9 million.

The Board has outstanding bonds payable of $538.0 million at June 30, 2008, compared to $440.6 at June 30, 2007. This increase is due to the issuance of the 2008 Series A and B Bonds. The total outstanding bonds payable as of June 30, 2006, were $454.0 million. The decreases noted over the previous two years are due to the normal retirement of bonds.

The Board's financing cost may be impacted by short-term and long-term debt ratings assigned by independent rating agencies. Debt ratings are based, in significant part, on the Board's performance as measured by certain credit measures such as the aforementioned cash targets and debt coverage ratios. The Board's debt coverage ratio for the 12 months ended June 2008 was 3.3 to 1. The Board continues to exceed its goal of 2 to 1. The Board's revenue bonds are rated Aa, AA+, and AA by Moody's, Standard & Poor's, and Fitch, respectively. The outlook on all ratings is stable.

Respectfully submitted,

Teresa Broyles-Aplin
Vice President and
Chief Financial Officer

STATEMENTS OF NET ASSETS ($000 OMITTED)
JUNE 30, 2008 AND 2007

	2008	2007
ASSETS		
CURRENT ASSETS:		
Cash and short-term investments	$ 94,776	$ 93,157
Customer and other accounts receivable, less allowance for doubtful accounts of $687 and $607, respectively	117,129	100,064
Accrued interest receivable	836	859
Materials and supplies	17,496	18,067
Other current assets	1,650	1,465
TOTAL CURRENT ASSETS	231,887	213,612
INVESTMENT OF RESTRICTED FUNDS:		
Cash and cash equivalents	22,791	43
Other investments	127,985	47,849
TOTAL RESTRICTED FUNDS	150,776	47,892
UTILITY PLANT:		
Electric plant, at cost	1,213,568	1,153,066
Less: Accumulated depreciation	(438,549)	(410,733)
TOTAL UTILITY PLANT, NET	775,019	742,333
ENERGY CONSERVATION PROGRAMS' NOTES RECEIVABLE	550	789
UNAMORTIZED BOND ISSUANCE COSTS	2,997	2,341
OTHER NON-CURRENT ASSETS	303	362
TOTAL ASSETS	1,161,532	1,007,329

See notes to financial statements.

STATEMENTS OF NET ASSETS ($000 OMITTED)
JUNE 30, 2008 AND 2007 (continued)

	2008	2007
LIABILITIES		
CURRENT LIABILITIES:		
Accounts payable for purchased power	109,640	92,506
Other accounts payable and accrued expenses	23,352	16,474
Customer deposits	11,781	11,346
TOTAL CURRENT LIABILITIES	144,773	120,326
CURRENT LIABILITIES PAYABLE FROM RESTRICTED ASSETS:		
Construction contracts payable	1,023	1,675
Accrued interest payable	1,737	2,359
Current portion of long-term debt	13,875	12,491
TOTAL CURRENT LIABILITIES PAYABLE FROM RESTRICTED ASSETS	16,635	16,525
LONG-TERM DEBT, LESS CURRENT PORTION	524,099	428,091
OTHER NON-CURRENT LIABILITIES:		
Payable to TVA—energy conservation programs	550	789
Other	3,376	2,978
TOTAL OTHER NON-CURRENT LIABILITIES	3,926	3,767
COMMITMENTS AND CONTINGENCIES		
TOTAL LIABILITIES	689,433	568,709
NET ASSETS		
Invested in capital assets, net of related debt	339,793	302,464
Restricted	48,265	45,532
Unrestricted	84,041	90,624
TOTAL NET ASSETS	$ 472,099	$ 438,620

See notes to financial statements.

STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS ($000 OMITTED)
YEARS ENDED JUNE 30, 2008 AND 2007

	2008	2007
OPERATING REVENUES:		
Residential	$ 420,888	$ 391,316
Commercial and industrial	578,317	540,998
Street and highway lighting	14,284	13,444
Other	17,464	17,070
Total operating revenues	1,030,953	962,828
PURCHASED POWER	794,786	733,735
MARGIN	236,167	229,093
OPERATING EXPENSES:		
Distribution	46,078	43,994
Customer accounts	18,387	17,397
Customer service and information	1,160	1,053
General and administrative	54,210	44,989
Tax equivalents	24,775	25,239
Depreciation	40,884	37,003
Total operating expenses	185,494	169,675
Operating income	50,673	59,418
NON-OPERATING REVENUE (EXPENSE):		
Interest income	5,736	8,788
Interest expense	(22,930)	(24,205)
Total non-operating expense	(17,194)	(15,417)
NET INCREASE IN NET ASSETS	33,479	44,001
NET ASSETS, Beginning of Year	438,620	394,619
NET ASSETS, End of Year	$ 472,099	$ 438,620

See notes to financial statements.

STATEMENTS OF CASH FLOWS ($000 OMITTED)
YEARS ENDED JUNE 30, 2008 AND 2007

	2008	2007
CASH FLOWS FROM OPERATING ACTIVITIES:		
Receipts from customers	$ 1,014,562	$ 964,956
Payments to suppliers for goods and services	(845,454)	(803,167)
Payments to employees	(45,682)	(41,963)
Payments for tax equivalents	(24,343)	(24,844)
Net cash provided by operating activities	99,083	94,982
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:		
Acquisition and construction of utility plant	(67,491)	(66,141)
Utility plant removal costs	(6,849)	(10,450)
Salvage received from utility plant retirements	770	1,018
Proceeds from sale of revenue bonds	111,850	-
Principal payments on revenue bonds	(12,491)	(12,703)
Interest paid on revenue bonds	(26,128)	(24,482)
Net cash used in capital and related financing activities	(339)	(112,758)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of investment securities	(344,842)	(177,992)
Proceeds from sales and maturities of investment securities	241,958	209,067
Interest on investments	5,759	8,061
Net cash (used) provided by investing activities	(97,125)	39,136
NET INCREASE IN CASH AND SHORT-TERM INVESTMENTS - UNRESTRICTED	1,619	21,360
CASH AND SHORT-TERM INVESTMENTS AT BEGINNING OF YEAR - UNRESTRICTED	93,157	71,797
CASH AND SHORT-TERM INVESTMENTS AT END OF YEAR - UNRESTRICTED	$ 94,776	$ 93,157

See notes to financial statements.

STATEMENTS OF CASH FLOWS ($000 OMITTED)
YEARS ENDED JUNE 30, 2008 AND 2007 (continued)

	2008	2007
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	$ 50,673	$ 59,418
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	40,884	37,003
Changes in assets and liabilities:		
(Increase) decrease in customer and other accounts receivable	(17,065)	1,062
Decrease (increase) in materials and supplies	571	(4,264)
(Increase) decrease in other current assets	(185)	21
Decrease in energy conservation programs' notes receivable	239	364
Decrease in other non-current assets	59	17
Increase in accounts payable for purchased power	17,134	3,020
Increase (decrease) in other accounts payable and accrued expenses	6,179	(2,137)
Increase in customer deposits	435	703
Decrease in payable to TVA–energy conservation programs	(239)	(364)
Increase in other non-current liabilities	398	139
Net cash provided by operating activities	$ 99,083	$ 94,982

NON-CASH CAPITAL AND RELATED FINANCING ACTIVITIES:

During 2008 and 2007, NES charged $8.7 million and $19.7 million, respectively, to accumulated depreciation representing the cost of retired utility plant.

During 2008 and 2007, $214,000 and $208,000, respectively, were charged to interest expense for amortization of bond premiums. Also, $599,000 and $629,000 were charged as amortization of the bond-issuance costs in 2008 and 2007, respectively.

During 2008, the 2008 Series B Bonds were offered to refund $74,430,000 and $13,240,000 aggregate principal amount of the Board's 1998 Series A and 1998 Series B Bonds, respectively.

See notes to financial statements.

NOTES TO FINANCIAL STATEMENTS

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Electric Power Board of the Metropolitan Government of Nashville and Davidson County (the "Board") was established in 1939 when the City of Nashville purchased certain properties of the Tennessee Electric Power Company for the purpose of exercising control and jurisdiction over the electric distribution system. In conducting the operations of the electric distribution system, the Board does business as Nashville Electric Service ("NES"). NES is a component unit of The Metropolitan Government of Nashville and Davidson County, Tennessee (the "Metropolitan Government"), and is operated by a five-member board appointed by the Mayor and confirmed by the Council of the Metropolitan Government. Members of NES serve five-year staggered terms without compensation. In accordance with the Charter of the Metropolitan Government, NES exercises exclusive control and management, except NES must obtain the approval of the Council before issuing revenue bonds. The Metropolitan Government does not assume liability for the financial obligations of NES. In addition, the assets of NES cannot be encumbered to satisfy obligations of the Metropolitan Government. NES appoints a chief executive officer, who is charged with the responsibility for the day-to-day operations, including hiring of employees.

The financial statements of NES have been prepared in conformity with accounting principles generally accepted in the United States of America. NES maintains its accounts in accordance with the Uniform System of Accounts prescribed by the Federal Energy Regulatory Commission on the accrual basis of accounting. NES is not subject to the jurisdiction of federal or state energy regulatory commissions.

Under Governmental Accounting Standards Board ("GASB") Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, NES has elected to apply Financial Accounting Standards Board ("FASB") Statements and Interpretations issued after November 30, 1989, except for those that conflict with or contradict GASB pronouncements.

The significant accounting policies followed by NES are outlined below.

Estimates used in the preparation of financial statements are based on management's best judgments. The most significant estimates relate to allowance for uncollectible accounts receivable, inventory obsolescence, depreciation, intangible asset valuations and useful lives, employee benefit plan obligations, accrued power receivable and payable, unbilled receivables, and unreported medical claims. These estimates may be adjusted as more current information becomes available.

For purposes of the statements of cash flows, cash and cash equivalents include unrestricted cash, commercial paper, U.S. Treasury Bills and certificates of deposit with an original maturity of three months or less.

Restricted Assets of NES represent bond proceeds designated for construction and other monies required to be restricted for debt service.

NOTES TO FINANCIAL STATEMENTS

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Utility Plant is stated at original cost. Such cost includes applicable general and administrative costs and payroll and related costs such as pensions, taxes and other fringe benefits related to plant construction. Interest cost incurred during the period of construction of certain plant is capitalized. Capitalized interest was $837 thousand and $547 thousand in 2008 and 2007, respectively. Costs of depreciable retired utility plant, plus removal costs, less salvage, are charged to accumulated depreciation.

Depreciation is provided at rates which are designed to amortize the cost of depreciable plant over the estimated useful lives ranging from 5 to 50 years. The composite straight-line rates expressed as a percentage of average depreciable plant were as follows for June 30, 2008 and 2007:

	2008	2007
Distribution Plant, 18.2 to 40 years	3.5%	3.3%
Structure and improvements, 40 to 50 years	2.1%	2.0%
Office furniture and equipment, 7.1 to 16.7 years	13.7%	13.8%
Transportation equipment, 8 to 10 years	6.7%	7.3%
Other equipment, 8 to 33.3 years	6.4%	6.5%

Maintenance and repairs, including the cost of renewals of minor items of property, are charged to either maintenance expense accounts or applicable clearing accounts. Replacements of property are charged to utility plant accounts.

Investments and Cash Equivalents (including restricted assets) consist primarily of short-term U.S. Government securities or securities from agencies chartered by Congress, and certificates of deposit. In accordance with GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and External Investment Pools*, investments are reflected at their fair value except those investments that have a remaining maturity at the time of purchase of one year or less and certificates of deposit, which are reflected at cost.

Materials and Supplies are stated at the moving weighted average cost.

Arbitrage Rebate Payable, which is included in other accounts payable and accruals, represents estimated amounts payable to the federal government for interest earnings on bond proceeds in excess of amounts allowed under federal regulations.

Unamortized Bond Issuance costs incurred in connection with the issuance of bonds are being amortized over the respective lives of the bond issues using the effective interest method.

Compensated Absences represent the liability for employees' accumulated vacation days. The general policy of NES permits the accumulation, within certain limitations, of unused vacation days.

NOTES TO FINANCIAL STATEMENTS

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Revenues are recognized from meters read on a monthly cycle basis. Service that has been rendered from the latest date of each meter-reading cycle to month end is estimated and accrued as unbilled revenue receivable.

NES purchases electric power from the Tennessee Valley Authority ("TVA"). The cost of purchased power is calculated based upon retail billing units adjusted for estimated line losses. NES accrues for unbilled purchased power based on retail billing units.

Asset Retirement Obligations are periodically reviewed in accordance with SFAS No. 143, *Accounting for Asset Retirement Obligations*, and management has concluded that, at present, NES does not have any such asset retirement obligations.

Operating and Non-operating Revenues and Expenses – Operating revenues include the sale of power and rental of electric property. Operating expenses include direct and indirect costs to operate and maintain the electric distribution system, including purchased power, fuel, depreciation, customer accounts, tax equivalents, and general and administrative costs. Non-operating revenues and expenses consist primarily of interest income and expense.

Income Taxes – NES is not subject to federal or state income taxes. While NES is not subject to property tax, NES pays tax equivalents in-lieu-of taxes to the Metropolitan Government and surrounding counties.

2. UTILITY PLANT AND ACCUMULATED DEPRECIATION

Utility plant activity for the years ended June 30, 2008 and 2007, was as follows ($000 omitted):

	Balance June 30, 2007	Additions	Transfers & Retirements	Balance June 30, 2008
Distribution plant	$ 975,909	$ 57,720	$ (7,145)	$ 1,026,484
Land and land rights	1,139	-	-	1,139
Structures and improvements	41,992	982	-	42,974
Office furniture and equipment	34,788	2,145	(1,499)	35,434
Transportation equipment	6,033	792	(40)	6,785
Other equipment	34,496	1,332	(16)	35,812
Construction work-in-progress (a)	58,709	6,231	-	64,940
	$ 1,153,066	$ 69,202	$ (8,700)	$ 1,213,568

NOTES TO FINANCIAL STATEMENTS

2. UTILITY PLANT AND ACCUMULATED DEPRECIATION (continued)

	Balance June 30, 2006	Additions	Transfers & Retirements	Balance June 30, 2007
Distribution plant	$ 912,935	$ 79,939	$ (16,965)	$ 975,909
Land and land rights	1,139	-	-	1,139
Structures and improvements	38,986	3,006	-	41,992
Office furniture and equipment	34,015	2,493	(1,720)	34,788
Transportation equipment	5,830	555	(352)	6,033
Other equipment	34,403	810	(717)	34,496
Construction work-in-progress (a)	77,655	-	(18,946)	58,709
	$ 1,104,963	$ 86,803	$ (38,700)	$ 1,153,066

(a) Represents the net activity to the construction work-in-progress account after transfers to plant accounts.

The related activity for accumulated depreciation for the years ended June 30, 2008 and 2007, was as follows ($000 omitted):

	Balance June 30, 2007	Provision	Original Cost	Cost of Removal	Salvage	Balance June 30, 2008
Distribution plant	$ 352,974	$ 34,251	$ (7,132)	$ (6,849)	$ 644	$ 373,888
Structures and improvements	13,246	871	-	-	-	14,117
Office furniture and equipment	22,943	4,794	(1,499)	-	-	26,238
Transportation equipment	1,181	432	(40)	-	111	1,684
Other equipment	20,389	2,234	(16)	-	15	22,622
	$ 410,733	$ 42,582	$ (8,687)	$ (6,849)	$ 770	$ 438,549

NOTES TO FINANCIAL STATEMENTS

2. UTILITY PLANT AND ACCUMULATED DEPRECIATION (continued)

	Balance June 30, 2006	Provision	Original Cost	Cost of Removal	Salvage	Balance June 30, 2007
Distribution plant	$ 349,108	$ 30,486	$ (16,955)	$ (10,450)	$ 785	$ 352,974
Structures and improvements	12,443	803	-	-	-	13,246
Office furniture and equipment	19,920	4,743	(1,720)	-	-	22,943
Transportation equipment	869	429	(352)	-	235	1,181
Other equipment	18,860	2,248	(717)	-	(2)	20,389
	$ 401,200	$ 38,709	$ (19,744)	$ (10,450)	$ 1,018	$ 410,733

NOTES TO FINANCIAL STATEMENTS

3. CASH AND INVESTMENTS

Cash and investments consist of the following ($000 omitted):

2008

	Cash & Short-term Investments	Bond Funds	Special Construction	Total	Weighted Average Maturity (Years)
Cash	$ 3,264	$ 22,787	$ 4	$ 26,055	-
Securities from Agencies Chartered by Congress	-	27,215	100,770	127,985	1.78
Other Investments	91,512	-	-	91,512	-
	$ 94,776	$ 50,002	$ 100,774	$245,552	1.04

2007

	Cash & Short-term Investments	Bond Funds	Special Construction	Total	Weighted Average Maturity (Years)
Cash	$ 484	$ 43	$ -	$ 527	-
U.S. Treasury Investments	-	47,849	-	47,849	0.35
Other Investments	92,673	-	-	92,673	-
	$ 93,157	$ 47,892	$ -	$141,049	0.12

Investments of $128 million and $28.1 million at June 30, 2008 and 2007 respectively, in U.S. Treasury Investments and Securities from Agencies Chartered by Congress are reported at fair value. Investments of $91.5 million and $112.4 million at June 30, 2008 and 2007, respectively, in U.S. Treasury investments, commercial paper and certificates of deposit are reported at cost.

The net increase in the fair value of investments during fiscal year 2008 was $75 thousand. This amount takes into account all changes in fair value (including purchases and sales) that occurred during the year. There was no unrealized gain on investments held at year-end.

NOTES TO FINANCIAL STATEMENTS

3. CASH AND INVESTMENTS (continued)

Custodial Credit Risk – As of June 30, 2008 and 2007, NES' cash held by financial institutions was $26.1 million and $527 thousand, respectively. Bank balances for such accounts totaled $96.6 million and $95.6 million, respectively. Deposits in financial institutions are required by State of Tennessee ("State") statute to be secured and collateralized by the institutions. The collateral must meet certain requirements and have a total minimum market value of 105 percent of the value of the deposits placed in the institutions less the amount protected by federal depository insurance. Collateral requirements are not applicable for financial institutions that participate in the State's collateral pool. As of June 30, 2008 and 2007, all of NES' deposits were held by financial institutions which participate in the bank collateral pool administered by the State Treasurer. Participating banks determine the aggregated balance of their public-fund accounts for the Metropolitan Government. The amount of collateral required to secure these public deposits is a certain percentage set by the State, depending on the financial institution, and must be at least that percentage of the average daily balance of public deposits held. Collected securities required to be pledged by the participating banks to protect their public-fund accounts are pledged to the State Treasurer on behalf of the bank collateral pool. The securities pledged to protect these accounts are pledged in the aggregate rather than against each individual account. The members of the pool may be required by agreement to pay an assessment to cover any deficiency. Under this additional assessment agreement, public-fund accounts covered by the pool are considered to be insured for purposes of credit risk disclosure.

Credit Risk – NES is authorized to invest in obligations of the U.S. Treasury and U.S. governmental agencies, securities from agencies chartered by Congress, certificates of deposit, commercial paper rated A1 or equivalent and bonds of the State of Tennessee. Each of these investments is insured and registered or held by NES or its agent in NES' name.

Concentration of Credit Risk – NES has a policy prohibiting investment of greater than $5 million or 20 percent of the total investment portfolio in any one issue, except for the U.S. Government or any of its agencies. In 2008, more than 5 percent of NES' investments are in securities from agencies chartered by Congress and a Public Fund Trust. These investments are 58.3 percent and 41.4 percent respectively, of NES' total investments. In 2007, more than 5 percent of NES' investments are in U.S. Treasury Investments and a Public Fund Trust. These investments are 34.0 percent and 65.5 percent, respectively, of NES' total investments.

Interest Rate Risk – NES restricts its investments to maturities less than two years from the date of settlement as a means of managing exposure to fair value losses arising from changes in interest rates.

NOTES TO FINANCIAL STATEMENTS

4. LONG-TERM DEBT

Long-term debt for the years ended June 30, 2008 and 2007, is as follows ($000 omitted):

	Balance June 30, 2007	Deductions/ Repayments	Additions/ Amortization/ Accretion	Balance June 30, 2008
Electric System Revenue Bonds, 1996 Series A, bear interest at rates from 5.5% to 6%, maturing through May 15, 2013, interest paid semi-annually.	$ 60,506	$ (6,716)	$ (2,944)	$ 50,846
Electric System Revenue Bonds, 1998 Series A, bear interest at rates from 5.125% to 5.40%, maturing through May 15, 2023, interest paid semi-annually.	93,390	(74,430)	2,040	21,000
Electric System Revenue Bonds, 1998 Series B, bear interest at rates from 4.75% to 5.50%, maturing through May 15, 2017, interest paid semi-annually.	50,156	(17,225)	138	33,069
Electric System Revenue Bonds, 2001 Series A, bear interest at rates from 4.50% to 5.125%, maturing through May 15, 2017, interest paid semi-annually.	108,568	(1,790)	(11)	106,767
Electric System Revenue Bonds, 2001 Series B, bear interest at 5.50%, maturing through May 15, 2014, interest paid semi-annually.	18,593	-	(11)	18,582
Electric System Revenue Bonds, 2004 Series A, bear interest at rates from 4.50% to 5.00%, maturing through May 15, 2029, interest paid semi-annually.	109,369	-	3	109,372
Electric System Revenue Bonds, 2008 Series A, bear interest at rates from 3.25% to 5.00%, maturing through May 15, 2033, interest paid semi-annually.	-	-	112,348	112,348
Electric System Revenue Bonds, 2008 Series B, bear interest at rates from 3.25% to 5.00%, maturing through May 15, 2023, interest paid semi-annually.	-	-	85,990	85,990
	440,582	$ (100,161)	$ 197,553	537,974
Less current portion of long-term debt	(12,491)			(13,875)
	$ 428,091			$ 524,099

NOTES TO FINANCIAL STATEMENTS

4. LONG-TERM DEBT (continued)

NES issues Revenue Bonds to provide funds primarily for capital improvements and for refundings of other bonds. All bond issues are secured by a pledge and lien on the net revenues of NES on parity with the pledge established by all bonds issued. Annual maturities on all long-term debt and related interest are as follows for each of the next five fiscal years and in five-year increments thereafter ($000 omitted):

	Principal	Interest
2009	$ 14,279	$ 27,450
2010	15,213	28,667
2011	15,165	28,749
2012	15,331	28,762
2013	19,646	24,481
2014-2018	143,511	76,603
2019-2023	153,786	61,075
2024-2028	113,730	27,918
2029-2033	47,313	5,602
Total	$ 537,974	$ 309,307

On June 27, 2008, the Board closed on the sale of the Metropolitan Government of Nashville and Davidson County, Tennessee, Electric System Revenue Bonds, 2008 Series A and B. The purpose of the 2008 Series A Bonds was to reimburse NES for a portion of the 2008 capital expenditures and to fund approximately 50 percent of NES' projected $218.9 million Capital Budget for the fiscal years ending June 30, 2009, through June 30, 2011. The remainder will be funded with operating revenues. The par amount of the 2008 Series A Bonds, $109.2 million, plus original issue premium, less underwriter discount, cost of issuance, and a deposit to the debt service reserve fund netted proceeds in the amount of $111.8 million of which $110 million was deposited into the Special Construction Fund, $1.6 million in the Debt Service Reserve Fund and $225 thousand into the General Fund. The proceeds in the Special Construction Fund will be drawn down quarterly over the next three years. The 2008 Series B Bonds were being offered to refund $74,430,000 aggregate principal amount of the 1998 Series A Bonds maturing May 15, 2015, 2016 and 2023, and to refund $13,240,000 aggregate principal amount of 1998 Series B Bonds maturing on May 15, 2009, 2010 and 2011. The Board believes it has sufficient debt capacity and a strong financial position. Therefore, the tax-exempt bond market is expected to be a future source of liquidity to supplement the cash flow from operations. The advance refunding was undertaken to reduce total debt service payments over the next 15 years by $6.8 million and resulted in an economic gain of $5.0 million.

The following bond issues have been defeased through advanced refundings; therefore, the balances indicated, which are still outstanding at June 30, 2008, do not appear as liabilities on the Board's Statement of Net Assets:

	Amounts Outstanding
1998 Series A Bonds	$ 74,430,000
1998 Series B Bonds	13,240,000

NES had a $25 million unsecured line of credit in 2008 and 2007 to be used for purchased power in case of a natural disaster. Borrowings under this line of credit bear a negotiated interest rate. At June 30, 2008 and 2007, there were no borrowings outstanding under this line of credit.

NOTES TO FINANCIAL STATEMENTS

5. OTHER NON-CURRENT LIABILITIES

NES' other non-current liabilities consist primarily of TVA energy conservation program loans and customer contributions. The following table shows the activity for the year ($000 omitted):

	June 30, 2007	Repayments	Additions	June 30, 2008
Other non-current liabilities	$ 3,767	$ (4,617)	$ 4,776	$ 3,926

NES is a fiscal intermediary for the TVA energy conservation programs whereby loans are made to NES' customers to be used in connection with TVA's Residential Energy Services Program. Pursuant to the terms of an agreement with TVA, the energy conservation loans made to NES' customers are funded and guaranteed by TVA.

6. PENSION PLAN

The Nashville Electric Service Retirement Annuity and Survivors' Plan (the "Plan") is a single-employer defined benefit pension plan administered by NES. The Plan provides retirement and survivors' benefits to members and beneficiaries. Cost-of-living adjustments are provided to members and beneficiaries annually. The Charter of the Metropolitan Government assigns the authority to establish and amend benefit provisions to NES. The Plan is not required to issue a separate financial report.

All full-time regular employees under age 65 are eligible to participate in the Plan. The vesting provision of the Plan provides for five-year cliff vesting. NES employees who retire at or after age 65 are entitled to annual retirement benefits payable monthly for life in an amount equal to 2 percent of final average compensation multiplied by years in the Plan not in excess of 35 years. Final average compensation is the average compensation in the 36 consecutive months in which compensation is highest. Unused sick leave may be used to increase credited service and benefit percentage under certain circumstances. Early retirement is an option beginning at age 55 with 15 years of credited service or at age 50 with 30 years of credited service with an actuarially-reduced monthly benefit.

If the participant has attained age 55, and his/her age plus service is 85 or greater, then there is no reduction for early receipt of the benefit. However, a participant cannot use accumulated sick leave to increase effective age to meet the requirements for this unreduced benefit. For a participant with 25 or more years of service, the minimum pension benefit is $1,600 per month.

The contribution requirements of NES are established and may be amended by NES. The Plan is currently non-contributory. NES' practice is to typically fund at least the minimum contribution for a 30-year funding level. The current rate is 27.13 percent of annual covered payroll. NES contributed 100 percent of the required contribution for the Plan years 2008 and 2007.

The annual required contribution for the current year was determined as part of the April 1, 2008, actuarial valuation using the frozen initial liability method. The actuarial assumptions included (a) 8.0 percent long-term investment rate of return and (b) projected salary increases of 4.5 percent. Both (a) and (b) included an inflation component. The assumptions include cost-of-living post-retirement benefit increases equal to 2 percent per year. The actuarial value of Plan assets is determined using techniques that smooth the effects of short-term volatility in the market value of investments over a three-year period. The unfunded actuarial accrual liability is being amortized over 30 years. The required schedule of funding progress below presents multi-year trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liability for benefits.

NOTES TO FINANCIAL STATEMENTS

6. PENSION PLAN (continued)

Schedule of employer contributions for the past three years is shown below ($000 omitted):

Plan Year	Annual Required Contribution	Percentage Contributed
2008	$ 15,203	100%
2007	14,938	100%
2006	13,165	100%

Schedule of funding progress for the past three years is shown below ($000 omitted):

Actuarial Valuation Date	Actuarial Value of Assets	Actuarial Accrued Liability (AAL) Entry Age	Unfunded Actuarial Accrued Liability (UAAL)	Funded Ratio	Covered Payroll	Unfunded Actuarial Accrued Liability as a Percent of Covered Payroll
	(a)	(b)	(b-a)	(a/b)	(c)	(b-a)/c
4/1/08	$ 284,387	$ 343,574	$ 59,187	0.83	$ 61,242	96.65%
4/1/07	270,549	331,081	60,532	0.82	58,298	103.83%
4/1/06	245,465	305,564	60,099	0.80	55,061	109.15%

In 1994, NES established a non-qualified Supplemental Executive Retirement Plan (the "SERP"). The SERP was limited to certain employees of NES. Benefits accrued at the rate of 5 percent of salary for each year of credited service not to exceed 12 years and vests at the rate of 20 percent for each year of service, reduced by the percentage accrued and vested under NES' qualified plan. Effective April 1, 2005, the Board merged the SERP with the NES Retirement Annuity and Survivors' Benefit Plan. Adding the SERP benefits to the Plan increased the funding requirements for the Plan, but the amounts that had accumulated in the SERP Trust were transferred to the Plan in order to offset those increased costs. Future payments that would have been made into the SERP Trust will be directed into the Plan. At the time of conversion, no benefits had been paid from the SERP. Any change in funding requirements is reflected in the above schedule.

7. DEFERRED COMPENSATION PLAN

NES has a deferred compensation plan (the "Plan") created in accordance with Internal Revenue Code ("IRC") Section 457. The Plan, which is available to all full-time employees, permits employees to defer a portion of their salary until future years. Employees may contribute up to the legal limit of their compensation to the Plan with NES providing a matching contribution of up to 3 percent of compensation. The deferred compensation is not available to employees until termination, retirement, death or unforeseeable emergency. The Plan provides that assets or income of the Plan shall be used for the exclusive purpose of providing benefits for participants and their beneficiaries or defraying reasonable expenses of administration of the Plan. Since the assets of the Plan are held in custodial and annuity accounts for the exclusive benefit of Plan participants, the related assets of the Plan are not reflected on the statements of net assets. Employees contributed $3.2 million and $3.0 million, and NES contributed $1.6 million and $1.6 million to the Plan during the years ended June 30, 2008 and 2007, respectively.

NOTES TO FINANCIAL STATEMENTS

8. POST-EMPLOYMENT BENEFITS

In addition to the pension benefits described in Note 6 and the deferred compensation benefits described in Note 7, NES provides post-retirement medical, dental, and life insurance benefits to all employees who retire from NES under the provisions of the qualified plan and supplemental executive retirement plan. Medical and dental benefits are also provided to their spouses. As of June 30, 2008, approximately 526 retirees meet those eligibility requirements. Expenses for these post-retirement benefits have previously been recognized as retirees report claims. Those incurred claims totaled $8.5 million and $6.8 million for the years ended June 30, 2008 and 2007, respectively. During the year ended June 30, 2008, NES implemented the provisions of GASB Statement No. 45 titled *"Accounting and Financial Reporting by Employers for Post-Employment Benefits Other Than Pensions"*. These provisions were applied prospectively with respect to NES' Other Post-Employment Benefits (OPEB) Plan. GASB Statement No. 45 requires the accrual of OPEB obligations over the working careers of plan members rather than as claims are incurred. The total expense that was recognized under these new requirements during fiscal 2008 totaled $15.6 million.

The NES OPEB Plan is a single-employer defined benefit plan funded through an irrevocable trust that was established during the year ended June 30, 2008. The Charter of the Metropolitan Government assigns the authority to establish and amend benefit provisions to NES. The Plan is not required to issue a separate financial report.

NES' annual OPEB cost (expense) is calculated based on the annual required contribution (ARC), an amount actuarially determined in accordance with the parameters of GASB Statement No. 45. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost each year and to amortize any unfunded actuarial liabilities (or funding excess) over a thirty-year period beginning April 1, 2008. The current rate is 23.71 percent of annual covered payroll. NES contributed 100 percent of the required contribution for the Plan year.

Actuarial valuations involve estimates of the value of reported amounts and assumptions about the probability of events in the future. Amounts determined regarding the funded status of the plan and the annual required contributions of NES are subject to continual revision as actual results are compared to past expectations and new estimates are made about the future. The required schedule of funding progress presented below provides multi-year trend information that shows whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liability for benefits.

Projections of benefits are based on the substantive plan (the plan as understood by NES and plan members) and include the types of benefits in force at the valuation date and the pattern of sharing benefit costs between NES and the plan members to that point. Actuarial calculations reflect a long-term perspective and employ methods and assumptions that are designed to reduce short-term volatility in actuarial accrued liabilities and the actuarial value of assets. Significant methods and assumptions were as follows:

Actuarial valuation date: April 1, 2008

Actuarial cost method: Entry age, normal method

Amortization method: Level percentage of pay, open

Remaining amortization period: 30 years, closed

Asset valuation method: Adjust expected assets on the valuation date toward market value of assets by an amount equal to one-third of the difference between expected and market asset values

The actuarial assumptions included (a) 8.0 percent long-term investment rate of return and (b) projected salary increases of 4.5 percent. Both (a) and (b) included an inflation component. The assumptions include health care cost trend rate increases equal to 5 percent per year.

NOTES TO FINANCIAL STATEMENTS

8. POST-EMPLOYMENT BENEFITS (continued)

Schedule of employer contributions for the year is listed below:

Plan Year	Annual Required Contribution	Percentage Contributed
2008	$ 15,618,849	100%

Schedule of funding progress for the past two years is shown below ($000 omitted):

Actuarial Valuation Date	Actuarial Value of Assets	Actuarial Accrued Liability (AAL) Entry Age	Unfunded Actuarial Accrued Liability (UAAL)	Funded Percentage	Covered Payroll	Unfunded Actuarial Accrued Liability as a Percent of Covered Payroll
	(a)	(b)	(b-a)	(a/b)	(c)	(b-a)/c
4/1/08	$ 9,031	$ 212,858	$ 203,827	4.20	$ 64,890	314.1%
4/1/07	-	219,435	219,435	-	61,668	355.8%

9. LEASES

Total rental expense entering into the determination of net operating income amounted to approximately $998 thousand and $874 thousand in 2008 and 2007, respectively. Rental expense consists primarily of payments for facilities rental and leasing arrangements for software licensing. NES leases these facilities and software under various cancelable lease agreements. Rental income is received under pole-attachment leases, which are accounted for as operating leases. These leases are cancelable. Therefore, future minimum rentals under these leases are not significant. Rental income from this source totaled $2.1 million and $1.9 million for the years ended June 30, 2008 and 2007, respectively.

10. RISK MANAGEMENT AND LIABILITY

NES is exposed to various risks of loss related to torts; theft or damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. NES is an agency of the Metropolitan Government and is covered under the Tennessee Governmental Tort Liability Act, TCA 29-20-101, et al, (the "Act") and is self-insured under the act for tort liability. NES is immune from any award or judgment for death, bodily injury and/or property damage in excess of the limits as set fourth in the Act. Therefore, NES has not secured insurance coverage in excess of such limits. NES is a participant in the Metropolitan Government Insurance Pool (the "Pool") for coverage of most property losses. The Pool is currently operated as a common risk management and insurance program for several public entities, including NES, the Metropolitan Nashville Airport Authority, the Metropolitan Transit Authority and the Department of Water and Sewerage Services. The Pool is self-sustaining through member premiums. NES subrogates for all losses paid out for the negligence of other parties.

NOTES TO FINANCIAL STATEMENTS

10. RISK MANAGEMENT AND LIABILITY (continued)

NES is self-insured for employee dental claims and self-insured up to $100,000 for employee medical claims. The changes in the insurance reserves for medical and dental benefits for the years ended June 30, 2008 and 2007, are as follows ($000 omitted):

Balance—June 30, 2006	$ 2,500
Payments	(16,391)
Incurred Claims	15,806
Balance—June 30, 2007	1,915
Payments	(16,171)
Incurred Claims	16,051
Balance—June 30, 2008	$ 1,795

NES continues to carry commercial insurance for all other risks of loss, including a retention with excess workers' compensation coverage and employee health and accident insurance. Settled claims resulting from these risks have not exceeded commercial insurance coverage in any of the past three fiscal years.

NES is party to various lawsuits filed against it in the normal course of business. Management does not believe that damages, if any, arising from outstanding litigation, will have a material effect on the financial position of NES.

11. COMMITMENTS AND CONTINGENCIES

NES has entered into an agreement with an outside firm, whereby the firm provides computer hardware services operation for NES' mainframe information system. The agreement will expire in November 2008. The contract is for three years and may be renewed for two additional one-year periods. NES also has entered into an agreement with an outside firm, whereby the firm provides professional services for the management, operation and support of NES' information and data processing system. The agreement will expire in October 2008. The contract may be renewed for one additional one-year period. The minimum commitments remaining under these agreements are $6.2 million (2009) and $1.8 million (2010).

NOTES TO FINANCIAL STATEMENTS

12. RELATED PARTY TRANSACTIONS

NES had related party balances and transactions as a result of providing electric power to the Metropolitan Government and entities of the Metropolitan Government, as well as making tax equivalent payments to the Metropolitan Government and other payments to entities of the Metropolitan Government. These balances and transactions as of and for the years ended June 30, 2008 and 2007, are summarized as follows ($000 omitted):

	2008	2007
Balances:		
Accounts receivable	$ 1,965	$ 2,370
Accounts payable	98	11
Transactions:		
Commercial and industrial revenue—Metropolitan Government Entities	47,562	43,757
Street and highway lighting revenue—Metropolitan Government Entities	5,361	5,051
Tax equivalents operating expense—Metropolitan Government Entities	23,105	23,693

13. FAIR VALUE OF FINANCIAL INSTRUMENTS

Fair Value of Financial Instruments has been determined by NES using available market information. However, judgment is required in interpreting market data to develop the estimates of fair value. Accordingly, the fair values are not necessarily indicative of the amounts that NES could realize in a current market exchange. The carrying amounts of cash and short-term investments, investment of special funds, accounts receivable and accounts payable are a reasonable estimate of their fair value. The fair value of NES' long-term debt is estimated based on the quoted market prices for the same or similar issues. The fair value of NES' long-term debt is estimated to be $554 million and $461 million at June 30, 2008 and 2007, respectively.

PHOTOGRAPHY: *Dean Dixon, Dean Dixon Photography*

Metro Parks and Recreation Department 's Bells Bend Outdoor Center and Beaman Park Nature Center photography:
Tim Hill, NES Corporate Communications Supervisor

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