

AEP Texas Central Transiton Funding LLC

2003 Annual Report

Financial Statements Together with Independent Auditors' Report



AEP: America's Energy Partner®

AEP TEXAS CENTRAL TRANSITION FUNDING LLC
STATEMENTS OF INCOME
For the Years Ended December 31, 2003 and 2002

	2003	2002
OPERATING REVENUES		
Transition Charge Revenue	\$92,974,835	\$90,643,471
Investment Revenue	<u>329,311</u>	<u>483,917</u>
TOTAL	<u>93,304,146</u>	<u>91,127,388</u>
OPERATING EXPENSES		
Interest Expense	41,775,991	38,661,221
Amortization of Transition Property	46,821,344	50,013,046
Amortization of Transition Notes Discounts and Issuance Costs	4,094,837	1,852,853
Other Operating Expense	<u>532,407</u>	<u>600,268</u>
TOTAL	<u>93,224,579</u>	<u>91,127,388</u>
NET INCOME	<u>\$79,567</u>	<u>\$-</u>

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

AEP TEXAS CENTRAL TRANSITION FUNDING LLC
STATEMENTS OF MEMBER'S EQUITY
For the Years Ended December 31, 2003 and 2002

	Member's Equity	Retained Earnings	Total
JANUARY 1, 2002	\$-	\$-	\$-
Net Contributions of Capital	3,986,675	-	3,986,675
Net Income	<u>-</u>	<u>-</u>	<u>-</u>
DECEMBER 31, 2002	3,986,675	-	3,986,675
Net Contributions of Capital	-	-	-
Net Income	<u>-</u>	<u>79,567</u>	<u>79,567</u>
DECEMBER 31, 2003	<u>\$3,986,675</u>	<u>\$79,567</u>	<u>\$4,066,242</u>

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

AEP TEXAS CENTRAL TRANSITION FUNDING LLC
BALANCE SHEETS
December 31, 2003 and 2002

	<u>2003</u>	<u>2002</u>
<u>ASSETS:</u>		
<u>CURRENT ASSETS</u>		
Transition Charge Receivable – Affiliated	<u>\$14,916,549</u>	<u>\$12,416,758</u>
TOTAL	<u>14,916,549</u>	<u>12,416,758</u>
<u>OTHER ASSETS</u>		
Restricted Funds Held by Trustee	62,681,450	84,073,010
Unamortized Debt Issuance and Other Qualified Costs	27,010,468	31,047,514
Prepayments	1,827	-
Intangible Transition Property Net of Accumulated Amortization of \$74,335,363 in 2003 and \$29,143,150 in 2002	<u>689,399,126</u>	<u>734,591,339</u>
TOTAL	<u>779,092,871</u>	<u>849,711,863</u>
TOTAL ASSETS	<u>\$794,009,420</u>	<u>\$862,128,621</u>
 <u>LIABILITIES AND MEMBER'S EQUITY:</u>		
<u>CURRENT LIABILITIES</u>		
Current Portion of Long-term Debt	\$48,551,004	\$51,012,778
Accrued Interest	19,040,722	38,661,221
Customer Deposits	2,492,575	1,600,058
Accounts Payable – Affiliated	<u>230,984</u>	<u>375,915</u>
TOTAL	<u>70,315,285</u>	<u>91,649,972</u>
<u>OTHER LIABILITIES</u>		
Transition Notes, Net of Unamortized Discount of \$642,250 in 2003 and \$700,041 in 2002	697,128,865	745,622,078
Transition Charge Regulatory Liability	<u>22,499,028</u>	<u>20,869,896</u>
TOTAL	<u>719,627,893</u>	<u>766,491,974</u>
TOTAL LIABILITIES	<u>789,943,178</u>	<u>858,141,946</u>
<u>MEMBER'S EQUITY</u>		
Member's Equity	3,986,675	3,986,675
Retained Earnings	<u>79,567</u>	<u>-</u>
TOTAL	<u>4,066,242</u>	<u>3,986,675</u>
TOTAL LIABILITIES AND MEMBER'S EQUITY	<u>\$794,009,420</u>	<u>\$862,128,621</u>

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

AEP TEXAS CENTRAL TRANSITION FUNDING LLC
STATEMENTS OF CASH FLOWS
For the Years Ended December 31, 2003 and 2002

	2003	2002
OPERATING ACTIVITIES		
Net Income	\$79,567	\$-
Adjustment for Non-Cash Items:		
Amortization of Transition Notes Discounts and Issuance Costs	4,094,837	1,852,853
Amortization of Transition Property	46,821,344	50,013,046
Changes in Other Assets and Liabilities:		
Transition Charge Receivables - Affiliated	(2,499,791)	(12,416,758)
Prepayments	(1,827)	-
Accrued Interest	(19,620,498)	38,661,221
Accounts Payable – Affiliated	(144,931)	(5,029,834)
Customer Deposits	892,517	1,600,058
Net Cash Flows From Operating Activities	29,621,218	74,680,586
INVESTING ACTIVITIES		
Purchase of Transition Property	-	(763,734,489)
Net Funds Transferred to Trustee	(91,017,708)	(84,073,010)
Funds From Trustee for Payment of Interest	61,396,490	-
Funds From Trustee for Payment of Principal	51,012,778	-
Net Cash Flows Used For Financing Activities	21,391,560	(847,807,499)
FINANCING ACTIVITIES		
Proceeds from Issuance of Transition Notes, Net of Issuance Costs of \$27,468,485 and Original Issue Discount of \$726,174	-	769,140,238
Retirement of Transition Notes	(51,012,778)	-
Equity Contribution from Member	-	3,986,675
Net Cash Flows From (Used For) Financing Activities	(51,012,778)	773,126,913
Net Change in Cash and Cash Equivalents	-	-
Cash and Cash Equivalents at Beginning of Period	-	-
Cash and Cash Equivalents at End of Period	\$-	\$-

Cash paid for interest net of capitalized amounts was \$61,396,490 and \$0 for 2003 and 2002, respectively.

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

1. BASIS OF PRESENTATION

AEP Texas Central Transition Funding LLC (Transition Funding) is a special purpose Delaware limited liability company, whose sole member is AEP Texas Central Company (TCC), and is a direct wholly-owned consolidated subsidiary of TCC. TCC is a public utility engaged in the generation and purchase of electric power, and the subsequent sale, transmission and distribution of that power. TCC is an operating subsidiary of American Electric Power Company, Inc. (AEP).

In June 1999, the State of Texas enacted the Texas Electric Choice Plan (the “Act”) to govern the restructuring of the electric industry in Texas and to provide competition for retail electric service beginning on January 1, 2002. Deregulation of the Texas retail electric utility industry under the Act requires electric utilities to unbundle their generation, transmission and distribution and retail electric services. While transmission and distribution services will continue to be provided by electric utilities, the statute authorizes retail electric providers (REPs), certified by the Public Utility Commission of Texas (PUCT), to provide electric energy and related services, including billing and collecting. The Act permits electric utilities to recover the loss in value of generation-related assets caused by the transition from a regulated environment to competition for retail electric generation services, as determined by the PUCT. Under the portion of the Act providing for securitization, the PUCT may authorize an electric utility to use securitization financing to recover generation-related regulatory assets and stranded costs through the issuance by the utility or its designee of transition bonds secured by or payable from transition property. Transition property is comprised of the right to impose, collect and receive irrevocable nonbypassable transition charges payable by TCC's existing and future retail customers in TCC's certificated service area as it existed on May 1, 1999. Pursuant to the Act, the PUCT issued a financing order on March 27, 2000 authorizing, among other things, TCC to cause Transition Funding to issue transition notes in an aggregate principal amount not to exceed \$797,334,897, including up-front qualified costs not to exceed \$33,600,408 in the aggregate.

Transition Funding was organized on October 28, 1999, under the laws of the State of Delaware for the sole purpose of acquiring and holding transition property acquired from TCC. Transition Funding had no operations until February 7, 2002. In connection with the acquisition of the transition property, Transition Funding agreed to (a) issue and register one or more series of transition notes; (b) pledge its interests in the transition property and other transition note collateral to secure the transition notes; (c) make debt service payments on the transition notes; and (d) perform other activities that are necessary, suitable or convenient to accomplish these purposes. The purchase price of such transition property was paid from the proceeds of transition notes issued by Transition Funding pursuant to an Indenture, dated as of February 7, 2002, between Transition Funding and U.S. Bank National Association, as indenture trustee, and secured by the transition property and other collateral.

Transition Funding was organized with the sole purpose of limited business activities as are necessary or reasonably related to the issuance of the transition notes. Transition Funding is structured and is operated in a manner such that even in the event of bankruptcy proceedings against TCC, the assets of Transition Funding will not be consolidated into the bankruptcy estate of TCC.

The assets of Transition Funding consist of the transition property and the other collateral, including capital transferred by TCC which is sufficient to meet certain requirements of the indenture between Transition Funding and the indenture trustee.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Operating Revenues

Transition charges are billed to REPs on behalf of Transition Funding by TCC as servicer. These transition charges are recorded as revenue by Transition Funding under the accrual method of accounting which generally recognizes revenue as earned, and includes revenues actually billed plus an estimate of revenue earned but not yet billed at the end of the period.

Investment Revenue

Transition Funding earns investment revenue on funds held by the indenture trustee which funds are invested as

allowed by the Indenture. Currently, all such funds are invested in money market funds having ratings in the highest investment category granted by the rating agencies. Investment revenue on transition charge collections is recognized as earned and serves to increase the Transition Charge Regulatory Liability by a corresponding amount since it will be used to make payments on the transition notes. Investment income on the capital account (Member's Equity) is recognized on payment dates, when it is determined such income is not required to satisfy payment obligations, in which case Transition Funding is entitled to such revenues. During 2003, \$79,567 of such investment income was earned. The deposited cash and investment revenue from both transition charge collections and the capital account until earned are included in Restricted Funds Held by Trustee on the balance sheet.

Debt Issuance Costs & Other

The costs associated with the issuance of the transition notes as well as the repurchase cost of certain outstanding bonds issued by TCC to be acquired with proceeds from the sale of transition property are capitalized and are being amortized over the life of the transition notes utilizing the effective interest method.

Discount on Notes

The discount associated with the transition notes is capitalized offsetting the transition notes on the balance sheet and is being amortized over the life of the transition notes utilizing the effective interest method.

Customer Deposits

REPs are required to meet certain minimum creditworthiness criteria established by the PUCT with respect to transition charges. These criteria generally require that the REP have certain minimum long-term unsecured credit ratings by the major rating agencies. Alternatively, REPs can post a cash deposit equal to two months' maximum expected transition charges, or an affiliate guarantee, surety bond, letter of credit, or any combination thereof. Affiliates offering such credit backup must also meet the minimum credit rating standards. The trustee holds cash deposits, affiliate guarantees, and letters of credit of \$2,490,782, \$17,524,690, and \$2,356,755 respectively as of December 31, 2003.

Regulation

The application of accounting principles generally accepted in the United States of America by Transition Funding differs in certain respects from applications by non-regulated businesses. Transition Funding prepares its financial statements in accordance with the provisions of Statement of Financial Accounting Standards No. 71, "Accounting for the Effects of Certain Types of Regulation" (SFAS 71). In general, SFAS 71 recognizes that accounting for rate-regulated enterprises should reflect the economic effects of regulation. As a result, a regulated utility is required to defer the recognition of costs (a regulatory asset) or the recognition of obligations (a regulatory liability) if it is probable that, through the rate-making process, there will be a corresponding increase or decrease in future rates. Accordingly, Transition Funding recorded the transition property at acquired cost as an intangible asset acquired from TCC, which is being amortized over the life of the transition notes based on estimated revenue from transition charges, interest accrual and other related expenses. The financing order limits the terms of the transition notes to no greater than 15 years. In accordance with SFAS 71, amortization of transition property expense is adjusted for over/under recovery of transition charges. The accumulated over/under-recovery is recorded as either a liability or asset on the balance sheet.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires in certain instances the use of estimates and assumptions that affect the reported amounts of assets and liabilities along with the disclosure of contingent liabilities at the date of the financial statements. Actual results could differ from those estimates.

Federal Income and Texas Franchise Taxes

As a single-member limited liability company, Transition Funding is treated as a disregarded entity for federal tax purposes, and hence, its results of operations will be consolidated with TCC's for federal income tax reporting purposes.

For Texas franchise tax purposes, Transition Funding is treated as a separate corporate entity subject to Texas franchise tax. However, pursuant to the Act, both the transfer of the transition property and the collection of transition fees are exempt from Texas franchise tax.

Accordingly, there is no provision for income or Texas franchise taxes.

Reclassifications

Certain previously reported amounts have been reclassified to conform to current classifications with no effect on net income or member's equity.

3. ORIGINAL ISSUANCE

On February 7, 2002, Transition Funding issued \$797,334,897 of transition notes in five classes with final legal maturities ranging from 5 years to 15 years. The significant terms of the transition notes issued by Transition Funding in February 2002 are as follows:

	<u>Initial Principal Balance</u>	<u>Interest Rate</u>	<u>Proceeds To Issuer (a)</u>	<u>Scheduled Final Payment Date</u>	<u>Final Maturity Date</u>
Class A-1	\$128,950,233	3.54%	\$128,461,963	1/15/05	1/15/07
Class A-2	154,506,810	5.01%	153,739,267	1/15/08	1/15/10
Class A-3	107,094,258	5.56%	106,470,016	1/15/10	1/15/12
Class A-4	214,926,738	5.96%	213,606,937	7/15/13	7/15/15
Class A-5	<u>191,856,858</u>	6.25%	<u>190,463,517</u>	1/15/16	1/15/17
Total	<u>\$797,334,897</u>		<u>\$792,741,700</u>		

(a) Net of discounts and underwriters' fees

The annual maturities of the transition notes are as follows:

2004	\$48,551,004
2005	49,979,433
2006	52,264,786
2007	52,729,357
2008	50,107,327
Thereafter	<u>492,690,212</u>
Total	<u>\$746,322,119</u>

Accordingly, on February 8, 2002, TCC as servicer of the transition property implemented a nonbypassable transition charge on behalf of Transition Funding.

All transition note issuance costs incurred through December 31, 2001 (\$5,405,749) were paid by TCC and were reimbursed by Transition Funding upon issuance of the transition notes in 2002. The total issuance costs of \$33.6 million is composed of \$22.3 million for the net cost of TCC to reacquire certain of its bonds in the future in accordance with the financing order, underwriters fees of \$3.9 million, original issue discount of \$0.7 million and miscellaneous other costs of \$6.7 million.

4. SIGNIFICANT AGREEMENTS AND RELATED PARTY TRANSACTIONS

Notwithstanding the non-recourse nature of the transactions, TCC (individually, as servicer or otherwise) was required under the transaction documents (i) to make certain representations and warranties with respect to, among other things, the validity of Transition Funding's and its assignees' title to the transition property; and (ii) to observe certain covenants for the benefit of Transition Funding and its assignees. TCC is also required to indemnify Transition Funding against breaches of such representations and warranties and TCC's failure to perform its covenants and to protect such parties against certain other losses, which result from actions or inactions of TCC.

TCC is the initial servicer for Transition Funding under the transaction documents. The transaction documents contain provisions allowing the servicer to be replaced under limited circumstances. The servicer is paid a servicing fee in consideration for billing and collection of transition charges on behalf of Transition Funding, calculating the true-up adjustments and performing related services. Such fees paid to TCC for the years ended December 31, 2003 and 2002 were \$399,000 and \$376,000, respectively, and are included in Other Operating Expense.

5. SUBSEQUENT EVENTS

New transition charge rates designed to decrease projected overall annual revenues by 1.3% went into effect with the February 2004 billing cycles as a result of the scheduled annual true-up proceeding.

INDEPENDENT AUDITORS' REPORT

To the Member/Shareholder
of AEP Texas Central Transition Funding LLC:

We have audited the accompanying balance sheets of AEP Texas Central Transition Funding LLC (the Company), a wholly-owned subsidiary of AEP Texas Central Company, as of December 31, 2003 and 2002, and the related statements of income, member's equity, and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We have 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, such financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2003 and 2002, and the results of its operations and cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

/s/ Deloitte & Touche LLP

Columbus, Ohio
March 17, 2004