

DIRECTOR'S UPDATE

John Fredell, SDS Program Director

Preparing to build a water project the magnitude of the Southern Delivery System (SDS) requires three key components: approvals, funding and expertise. After more than a decade of planning, I'm pleased to report that each of these fundamental components are now in place to commence construction on this historic project.

The latest project milestone was achieved in August when the SDS partner communities – Colorado Springs, Fountain, Security and Pueblo West – negotiated long-term contracts with the U.S. Bureau of Reclamation to store, convey and exchange our water using Pueblo Reservoir.

The contracts will secure a reliable means to store and deliver our water to meet our communities' needs for decades to come. We will carry this momentum into construction of this critical project.

In May, we took another essential step forward when the Colorado Springs City Council approved a phased-in water rate program to fund construction of SDS and the costs for operating and maintaining the city's existing water system. Planned rate adjustments provide the assurance to investor and rating agencies for the bonds needed to fund the project. By issuing 40-year bonds to fund SDS, we're able to spread the costs over a longer term which levels out rate adjustments for our customers. Even with the investment of SDS, our water remains a great value. When SDS begins operation, a gallon of water delivered directly to customer homes and businesses will still cost less than a penny.

Finally, we are lining up the expertise to build SDS by advancing the contracting for the project. We selected two highly qualified prime contractors to begin SDS construction activities this year, including the connection

to Pueblo Dam and a portion of the finished-water pipeline construction along Marksheffel Road in El Paso County.

We had a high level of participation at three Business Opportunity Workshops we hosted in El Paso, Pueblo and Fremont Counties, which underscores the economic benefits of this project and that many contractors, vendors and suppliers are eager to compete for work on SDS. Current economic conditions are helping us manage project costs with historically low interest rates and competitively priced materials and services. We recently issued \$180 million in 40-year Build America Bonds at a rate of 3.62 percent which will save customers tens of millions in interest. These favorable conditions make it an opportune time to build the project.

With these key components in place, we are poised to begin construction. SDS will create jobs, support our economy and quality of life, and enable our communities to thrive for years to come. We appreciate the steadfast support we've received from so many community leaders, agencies, businesses and residents. Without you, we would not be where we are today.

Sincerely,

John Fredell, SDS Program Director

Accomplishments and Activities

PERMITTING

Water Conservation Board Adopts SDS Fish and Wildlife Mitigation Plan

In May, the Colorado Water Conservation Board adopted the Fish and Wildlife Mitigation Plan for SDS. Developed by the project participants in partnership with the Colorado Division of Wildlife, the plan was approved by the Colorado Wildlife Commission as well. It will serve as the State of Colorado's official position on wildlife mitigation activities required for the project.

SDS mitigation will benefit fish and wildlife habitat and create new recreational opportunities at future SDS reservoir sites.

Pueblo County Amends 1041 Flood Control Mitigation Requirement

Pueblo County has determined there may be more effective solutions to improve flood capacity on Fountain Creek than the original requirement in its SDS 1041 Permit for sediment removal through dredging and construction of sediment-collection devices on the creek. As a result, Pueblo County replaced those requirements with a monetary payment. The payment of \$2.2 million is the amount estimated that SDS would have spent to complete the dredging and sediment removal mitigation and allows Pueblo County to leverage the money to make other flood protection improvements for Fountain Creek.

Giving back SDS Partners with Pueblo Habitat for Humanity

The SDS land acquisition team reached agreements this year with the owners of six houses in Pueblo West. The houses were acquired due to their close proximity to the pipeline alignment. The SDS team forged a partnership with the Pueblo Habitat for Humanity to put salvageable materials from these properties to beneficial reuse. In July, regional community leaders came together for an open house in Pueblo West to recognize this partnership and thank the property owners.

"We are very appreciative of how cooperative these property owners have been," said SDS Program Director John Fredell. "They have all been great to work with. And now it is gratifying to see the materials from these homes used for such a positive purpose."

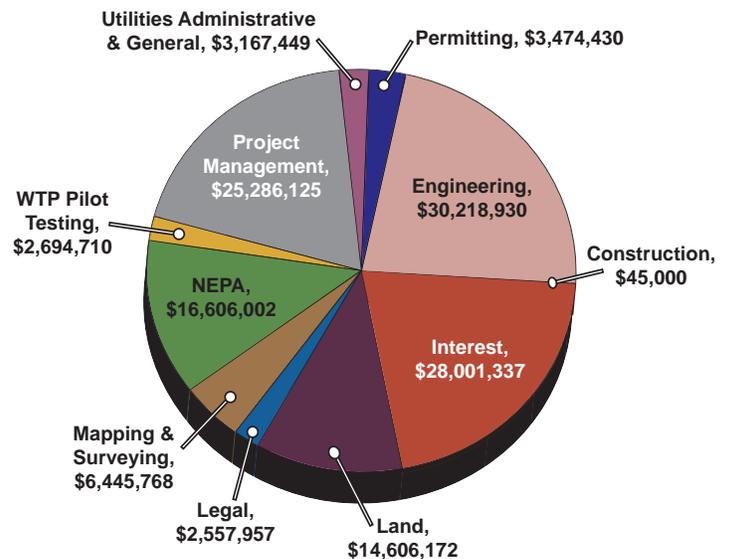
Habitat for Humanity has considerable experience in salvaging materials and is able to reuse many of the items in homes their volunteers are building for those in need. The reuseable items include appliances, doors, cabinets, lights, bathroom fixtures and hardware from doors and cabinets.

"Often, materials from homes purchased for municipal construction projects end up in a landfill. We were pleased Colorado Springs Utilities was willing to donate these items for positive reuse. This helps us by not having to purchase new materials, which reduces the cost of the homes for our clients," said Leonard Andrews, President of the Pueblo Habitat Board of Directors.



In July, Colorado Springs Utilities CEO Jerry Forte (left) and Colorado Springs Vice Mayor Larry Small (right) joined regional community leaders at an event in Pueblo West to recognize property owners and the donation to Pueblo Habitat for Humanity of reuseable materials from houses acquired for SDS.

SDS Capital Cost Distribution As of August 31, 2010 - \$133,103,880



CONTRACTING AND CONSTRUCTION

Finished-water pipeline construction begins

In September, construction began on the installation of a small portion of SDS with approximately 4,000 feet of parallel finished-water pipelines in El Paso County along Marksheffel Road – between Hwy 24 and Constitution Avenue. The pipeline will be part of the distribution system that delivers water to customers' homes and businesses.

The work is being done at the same time El Paso County is widening Marksheffel Road to minimize future disruption to area residents, businesses and traffic. By coordinating this work with the County's widening of this road, we will avoid the need to disturb a newly-paved road at a later date – saving about \$1 million. Work is scheduled through February 2011.

More than 200 Attend SDS Opportunity Workshops

More than 200 people attended three SDS Business Opportunity Workshops to learn about job and contracting opportunities from upcoming construction of SDS.

Colorado Springs Utilities hosted the workshops in El Paso, Pueblo and Fremont Counties to give contractors, suppliers and vendors an opportunity to talk with project staff and learn more about the schedule and the types of materials and services needed for the project. Prime contractors already selected for portions of the project were also available to network with potential subcontractors, including Garney Construction, hired to construct a portion of the finished-water pipeline in El Paso County, and ASI Constructors, the prime contractor hired to build the Pueblo Dam connection.

ASI Constructors is based in Pueblo County and specializes in the construction and rehabilitation of dams, spillways and major water resource projects. They plan to use several regional subcontractors for the dam-connection project.

Additionally, representatives with the Colorado Procurement Technical Assistance Center, Local Veterans Employment Representative, and the Pikes Peak Workforce Center provided information to workshop participants.

LAND AND FINANCE

Land Acquisition Progressing On Schedule, More than One-third of Properties Purchased

SDS land acquisition is progressing on schedule. The Colorado Springs City Council has authorized more than 130 property transactions, all involving consensual agreements. An estimated 300 properties – most of which are easements – will be needed for the project.

City Council Approves Phased-In Water Rates

In May, the Colorado Springs City Council approved a phased-in water rate program that will fund initial construction of SDS.

Beginning in January 2011, the typical monthly residential water bill will increase by about \$4.40 and in January 2012 will increase by another \$4.95. The phased-in approach will provide the funding needed for SDS and existing infrastructure while smoothing out water rate impacts for customers. More than 20 percent of the revenue from these changes will go toward maintaining the existing water system.

In the Spotlight

SDS negotiations for federal water contracts

From May through August, the SDS partners negotiated long-term contracts with the U.S. Bureau of Reclamation to store, convey and exchange water using the federal Fryingpan-Arkansas Project facilities, including Pueblo Reservoir.

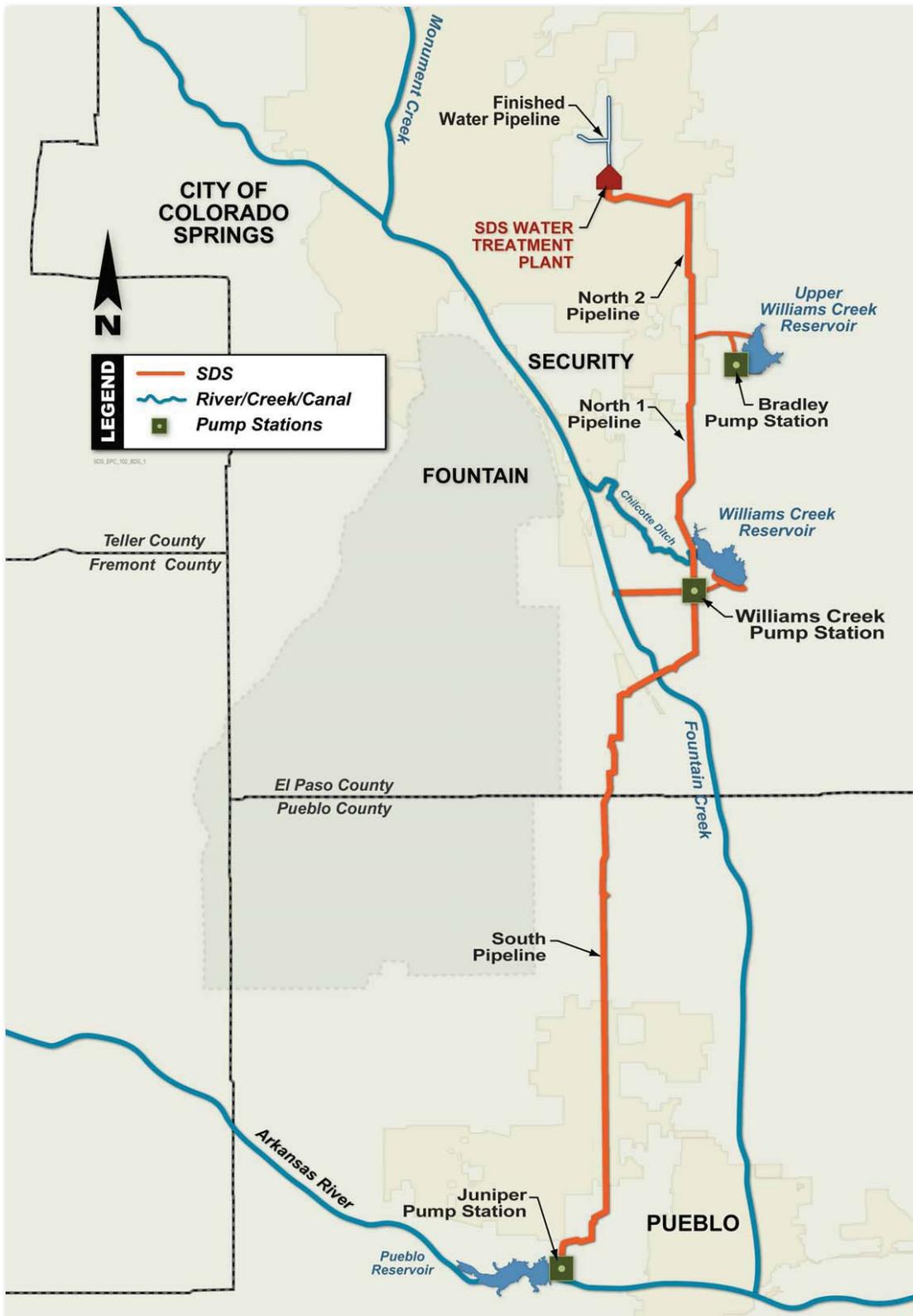
Under the contract terms, the SDS partners will pay \$0 for conveyance and \$36 per acre-foot for storage with a 1.79 percent annual escalation rate. Colorado Springs – the only partner with an exchange contract – would pay \$36 per acre-foot when an exchange is needed. Reclamation's closing price was significantly less than its initial proposal of \$150 per acre-foot for storage, conveyance and exchange with a 3.08 percent annual escalation rate.

The SDS project communities will invest an estimated \$31 million up front to construct the North Outlet Works

– the infrastructure needed for conveying water from Pueblo Reservoir to the SDS pipeline. As part of the negotiations, Reclamation agreed to pay \$5 million (net present value) for over-sizing the capacity of the North Outlet Works. The new outlet will benefit Reclamation and other water users by expanding the municipal/industrial capacity and providing redundancy as well as opportunities for future leases and revenues generated for Reclamation.

In total, the contracts amount to approximately \$70 million for the SDS partner communities over a 38-year period – almost 80 percent less than Reclamation's starting offer in May of nearly \$350 million. Colorado Springs' portion would be approximately \$45 million over the contract period.

SOUTHERN DELIVERY SYSTEM



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Colorado Springs Utilities

It's how we're all connected



"Where Eagles Soar"

Project Components

Phase 1: 62 miles of underground pipeline | 1 water treatment plant | 3 water pump stations

Phase 2: Terminal storage reservoir | Exchange reservoir | Expand water treatment plant