SMART GROWTH

STRATEGIC PLANS YIELD SMART GROWTH

As we look back on 2014 — and even the past 5 to 6 years — PEC's progress is truly noteworthy. The Co-op continues to evolve into a best-in-class organization, working to reduce controllable costs and maintaining some of the strongest reliability statistics in the industry. We've attained those achievements while becoming a national model of open governance and transparency among electric cooperatives.

This evolution is no accident. Board directors have been laying the necessary foundation for smart growth for years. We clearly understand planning and strategy need to be aligned — and in 2014 we continued to redefine how PEC will serve some of the country's fastest-growing regions.

The Cooperative's financial health has never been better, and we have a clean audit, strong bond rating and an outstanding debt-to-equity ratio.

The Board continues to push its commitment to clean energy, revising PEC's interconnection policy to more equitably compensate members who sell self-generated electricity back to the Cooperative. And PEC is looking at continuing to expand its portfolio of renewable energy, offering the possibility for members to access on-site or community solar options for residents and businesses.

Perhaps most importantly, the Co-op increased member equity and reduced rates — a key strategic initiative — while also beginning a thorough cost-of-service and rates study. We anticipate this study, when completed, will result in more rate options for members in the future.

Smarter, faster, cheaper — that's what all of us are striving for at PEC, now and in the future.

Dr. Patrick Cox
PEC Board President

IMPLEMENTING STRATEGY AT GROUND LEVEL

Our team has taken the strategic direction developed by the Board and turned it into action. I am excited by the myriad efforts that were undertaken in 2014.

Our focus was and is on working with our great people to bring the benefits of technology to members, increasing the Co-op's capabilities while maintaining our excellent service and reliability. We worked tirelessly to provide more value to our growing membership, and our accomplishments in 2014 — automated vehicle location software, work on a new enterprise software system and streamlined PEC processes — all reflect that dedication.

PEC employees made great strides toward providing the Co-op's services at a lower cost. PEC's strong financial position, AA- bond rating and clean financial audit made possible a rate reduction and planned additional future reductions.

Members can be confident management is seeking cost savings through the Co-op's power contracts, diversifying the energy portfolio and negotiating more-favorable terms and conditions with the Cooperative's main power supplier, the Lower Colorado River Authority.

PEC is squarely focused on members' renewable resources, and in 2014 increased the buyback rate paid to Co-op members who self-generate electricity and sell the excess back to PEC. The Co-op has begun working toward implementing an on-bill financing program for solar photovoltaic systems, leveraging the strength of the Co-op to help members gain access to beneficial interest rates. These projects could lower the total cost of solar system ownership.

These achievements occurred amidst the demands of continuous growth and with improved staffing ratios. We are excited about the possibilities the future brings as we continue incorporating a powerful team and new technologies to serve the membership even more effectively.

John Hewa
PEC Chief Executive Officer

GROWTH MEANS MORE THAN METERS AND MILES OF LINE

PEC provides electric service to more members than any distribution cooperative in the nation; that's a result of our location among some of the fastest-growing counties in the state and country. The vibrant area fueling the Co-op's growth is home to increasingly sophisticated and technologically savvy members, and our work is focused on delivering these members the tools they seek in today's environment.

PEC knows how to create and manage an electric distribution system. We've been doing that with pride and distinction for more than 75 years. In 2014, we began laying the foundation for innovative services that will bring more value to our members. A new software system will give members more information at their fingertips while allowing the Cooperative to be even more responsive.

A mapping system upgrade promises to speed power restoration and strengthen our enviable reliability record. In 2014, PEC also began a comprehensive, system-wide inventory of all PEC facilities, employing state-of-the-art location technology. The end result will help us pinpoint and address power interruptions and other service needs more quickly.

Other high-tech tools further streamlined member service. We installed automatic vehicle location technology in all PEC vehicles. The location of every service crew or bucket truck in the field can be found in moments, speeding dispatch calls during power interruptions and quickening restoration times. We've also added contact center features to more efficiently route outage or construction-related questions directly to the appropriate department.

These are only some of the more than 60 initiatives begun in 2014 to help make PEC the electric cooperative of the future. We don't see them just helping PEC evolve. We see them helping to expand traditional cooperative business services.

Reflecting the dynamic region PEC serves, the Co-op added more than 8,700 new accounts in 2014 — a growth rate of 3.4 percent.

New software allows PEC to track crews and more quickly respond to power interruptions.

NEW TOOLS, GREATER CAPABILITIES

An electric utility's core business is moving electrons from one location to another, and PEC is no different. Our primary responsibility is to keep our members and employees safe while maintaining world-class reliability to more than 264,000 meters. In 2014, the Cooperative expanded its use of tools in the field and in our offices to improve the member experience.

The Co-op began a multi-year installation of a new enterprise software system that will dramatically enhance member tools in 2015 and beyond. This software will give PEC members more control over their information and will provide a mobile application, an easy-to-use web portal and enhanced account management. PEC's ongoing goal is to give members more control over their accounts, energy consumption and interactions with the Co-op.

On the business side, PEC is using a financial forecasting tool that allows us to analyze and compare various financial and operational options. It enables the Co-op to envision the long-range impacts on PEC's finances arising from different rate designs, financing decisions, capital investment and cost-reduction plans.

PEC also implemented new technologies internally to assist employees in reaching strategic goals, and, externally, through contact center options to help our members.

All of these initiatives were undertaken while managing controllable costs, improving our financial strength, meeting equity targets and reducing rates.

STRENGTHENING BUSINESS AND COMMUNITY PARTNERSHIPS

As an electric cooperative, PEC is more than just a utility. It is a not-for-profit utility owned by its members, and we have a special responsibility to bring more than electricity to our service area. In 2014, we redoubled our efforts to forge active partnerships with our communities.

One manifestation of those partnerships was enhanced outreach to elected officials and community economic development representatives. The Co-op created an award-winning electronic newsletter for elected officials to help keep them informed of PEC's plans and accomplishments. Our CEO made personal contacts with many community representatives to ensure PEC's future infrastructure plans align with community growth projections.

We also unveiled a website dedicated to economic development in the region that features a searchable database of commercial sites and buildings throughout the Texas Hill Country. Free to use, the website provides property and demographic details to economic development professionals and corporate executives. The site is a robust tool providing unprecedented data sharing between local communities and prospective business partners.

PEC expanded capabilities to commercial members in 2014, giving them the ability to review daily, monthly and annual electric use and cost. The Co-op continued its outreach to commercial members to find ways to bring more value to these key accounts.

All of this outreach and effort was accomplished in conjunction with PEC's community giving and continued support of non-profits and charitable organizations that provide essential services to our members.

Above: texashillcountrysiteselection.com launched in 2014.

At left: PEC Key Accounts Manager Trey Grebe (R) with Seton Plant Supervisor Tyris Williams at Seton Medical Center Hays in Kyle, Texas.


PEC Chief Executive Officer John Hewa

CONTINUED GROWTH AND IMPROVEMENT

With 2014, PEC's employees provided increased value to the Co-op's membership by working smarter and more efficiently. This hardworking group is poised to take on important changes that will further improve service levels even more for members.

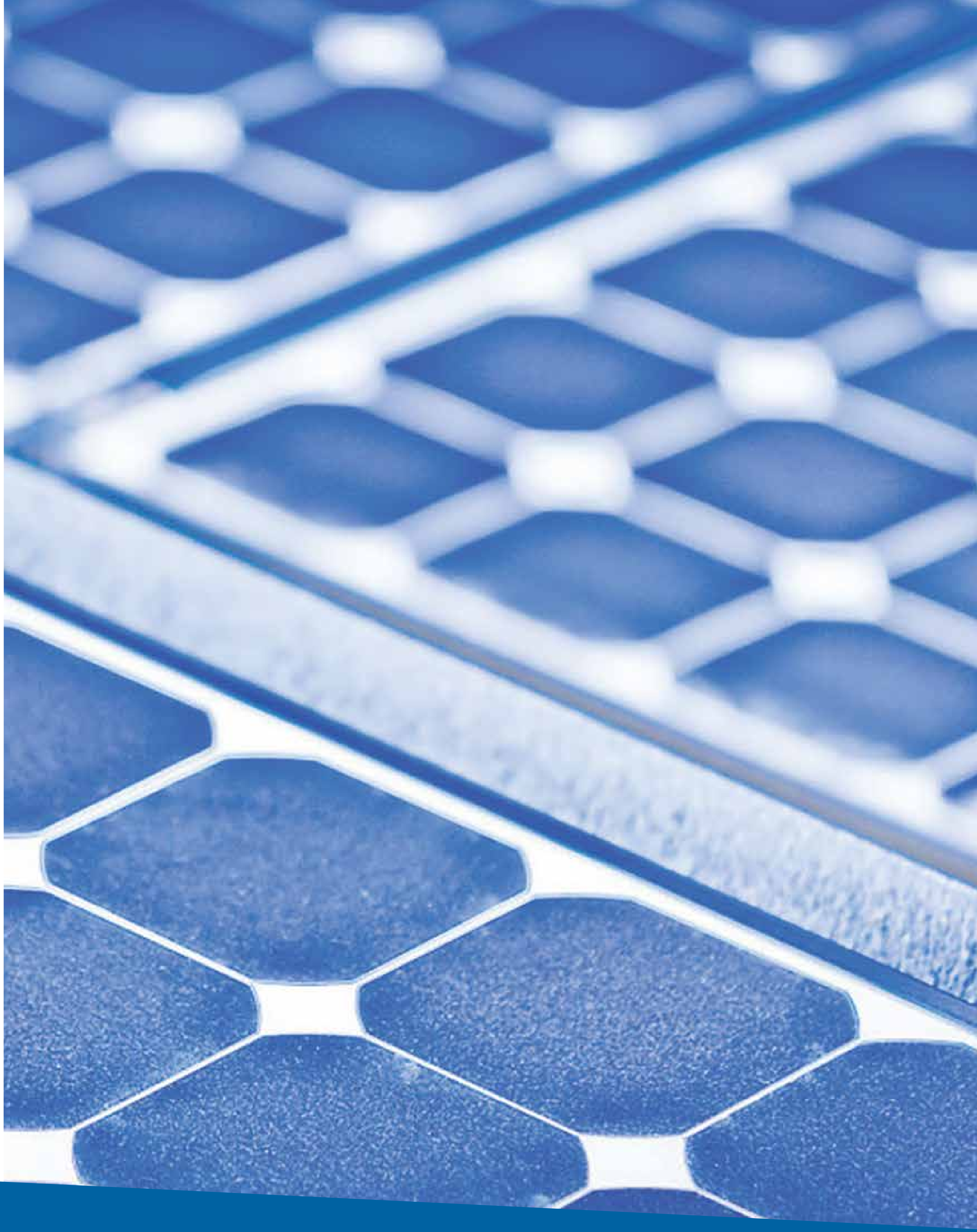
Employees are working on the implementation of our new enterprise software system, which will provide members a robust mobile application and feature-filled web portal. In the future, members can expect to see a real-time outage map, more-flexible billing options and a dynamic notification system.

The cost-of-service and rates study begun in 2014 is expected to yield more diverse rate choices for members. We anticipate more rate classes, including time-of-use and pre-paid options, that can better fit members' needs.

We will continue a relentless focus on lower rates and improved member service. This focus has already led to additional cost reductions for members in 2015, and PEC's management team continues to strive for ways to provide further savings and better value for the membership.

PEC looks to leverage recent positive pricing in the renewable energy market, working with providers to expand renewable energy in the Co-op's power portfolio and also to expand services to members. Community solar facilities and on-bill financing of renewable products are only two of the exciting initiatives in the realm of solar.

Long term, through its hardworking employees PEC is committed to becoming even more effective for its membership. Rest assured, a dedicated management team and this motivated employee base are working diligently to keep PEC growing smartly and become a cooperative of the future that gives members what they deserve.



PEC BOARD OF DIRECTORS

Dr. Patrick Cox
District 7 Director
President

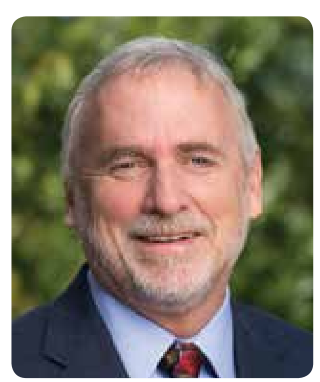
Kathryn Scanlon
District 3 Director
Vice President

Cristi Clement
District 1 Director
Secretary-Treasurer

Larry Landaker
District 6 Director

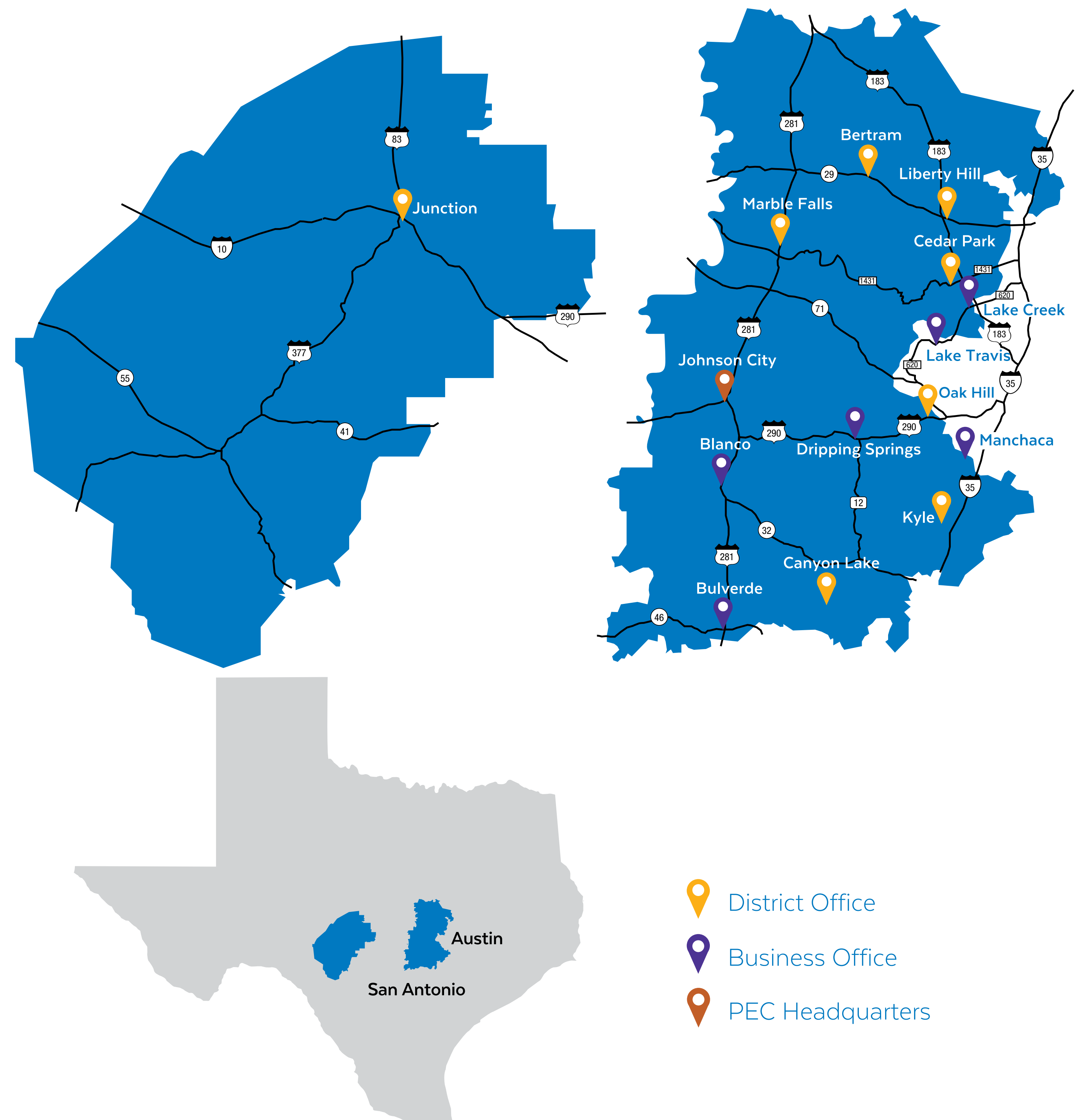
James Oakley
District 5 Director

Emily Pataki
District 2 Director

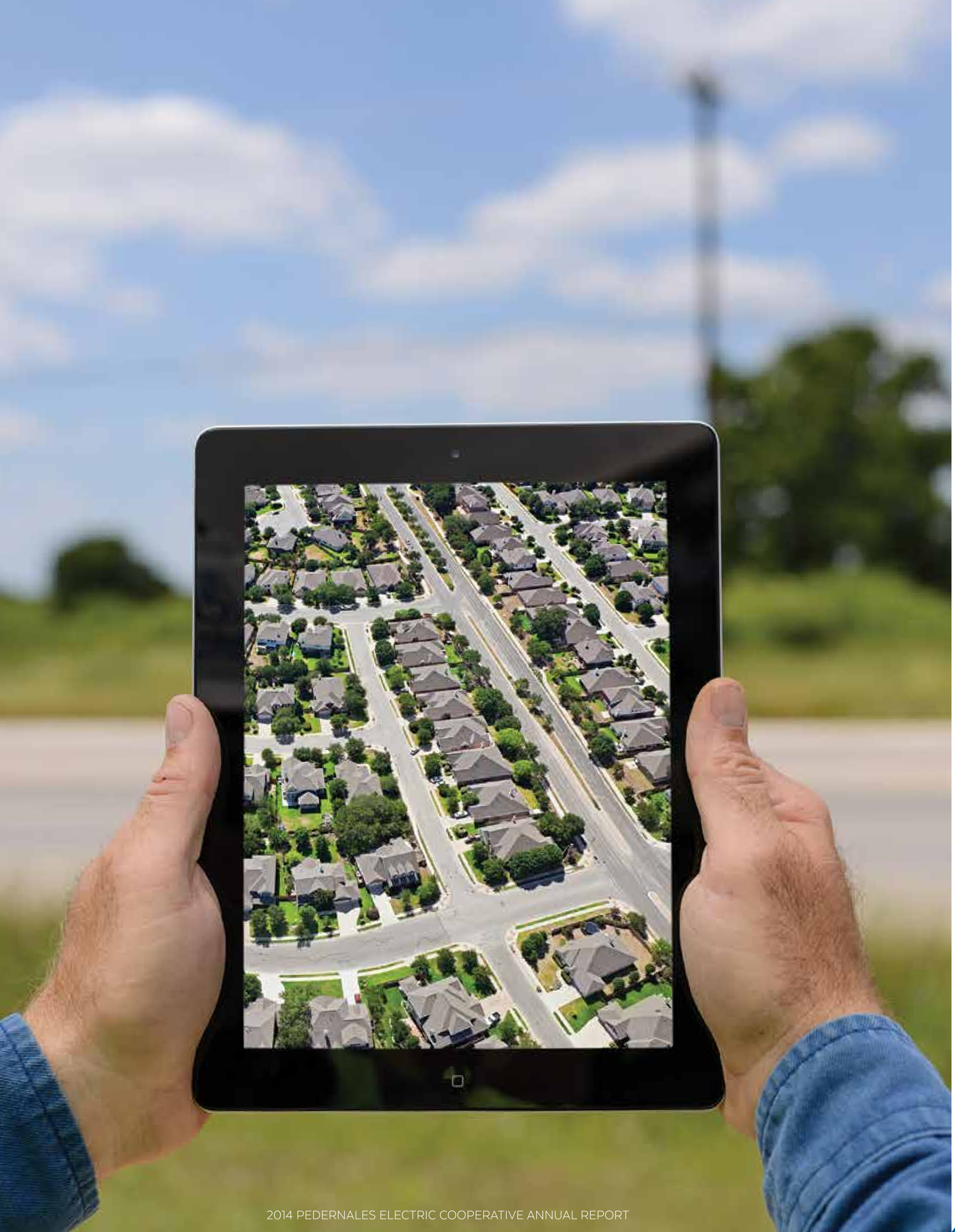


Chris Perry
District 4 Director

PEC SERVICE AREA



District Office
Business Office
PEC Headquarters



PEC by the numbers in 2014

Members	223,872
Active accounts	264,828
Employees	728
Miles of distribution line	20,971
Electricity sales	5,338,807,639 kwh
Service area	8,100 square miles
Total assets	$1,414,715,775

Pedernales Electric Cooperative
2014 Financial Report

PEDERNALES ELECTRIC COOPERATIVE, INC.

JOHNSON CITY, TX

FINANCIAL STATEMENTS WITH ACCOMPANYING INFORMATION

FOR THE YEARS ENDED DECEMBER 31, 2014 AND 2013

AND

REPORT OF CERTIFIED PUBLIC ACCOUNTANTS

PEDERNALES ELECTRIC COOPERATIVE, INC.
JOHNSON CITY, TX

FINANCIAL STATEMENTS WITH ACCOMPANYING INFORMATION
FOR THE YEARS ENDED DECEMBER 31, 2014 AND 2013

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Bolinger, Segars, Gilbert & Moss, L.L.P.
CERTIFIED PUBLIC ACCOUNTANTS
PHONE: (806) 747-3806
FAX: (806) 747-3815
8215 Nashville Avenue
Lubbock, Texas 79423-1954

Independent Auditor's Report

Board of Directors
Pedernales Electric Cooperative, Inc.
Johnson City, Texas

We have audited the accompanying financial statements of Pedernales Electric Cooperative, Inc. (the Cooperative), which comprise the balance sheets as of December 31, 2014 and 2013, and the related statements of income and patronage capital and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit 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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Pedernales Electric Cooperative, Inc. as of December 31, 2014 and 2013, and the results of their operations and cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Bolinger, Segars, Gilbert & Moss LLP

Certified Public Accountants

Lubbock, Texas

April 1, 2015

PEDERNALES ELECTRIC COOPERATIVE, INC.

BALANCE SHEET
DECEMBER 31, 2014 AND 2013

ASSETS

	December 31, 2014	December 31, 2013
UTILITY PLANT AT COST		
Utility Plant in Service	$ 1,443,552,804	$ 1,396,426,791
Construction Work in Progress	53,561,428	38,516,167
	$ 1,497,114,232	$ 1,434,942,958
Less: Accumulated Provision for Depreciation	299,040,123	275,768,895
	$ 1,198,074,109	$ 1,159,174,063
OTHER PROPERTY AND INVESTMENTS - AT COST OR STATED VALUE		
Investments in Associated Organizations	$ 11,434,891	$ 11,310,714
Other Investments	14,000,000	14,000,000
	$ 25,434,891	$ 25,310,714
CURRENT ASSETS		
Cash and Cash Equivalents	$ 36,792,681	$ 62,703,927
Accounts Receivable - Energy (Less allowance for uncollectibles of $54,424 in 2014 and $133,245 in 2013)	18,982,394	25,708,049
Accounts Receivable - Other (Less allowance for uncollectibles of $202,509 in 2014 and $371,557 in 2013)	6,188,313	1,806,143
Unbilled Revenue	25,475,400	26,404,200
Materials and Supplies Inventory	27,433,715	22,552,944
Power Cost Adjustments - Under-Recovered	6,321,464	
Other Current and Accrued Assets	2,338,360	1,583,085
Total Current Assets	$ 123,532,327	$ 140,758,348
DEFERRED CHARGES AND OTHER ASSETS	$ 67,674,449	$ 48,970,200
TOTAL ASSETS	$ 1,414,715,776	$ 1,374,213,325

EQUITIES AND LIABILITIES

	December 31, 2014	December 31, 2013
EQUITIES		
Memberships	$ 10,734,531	$ 10,328,522
Patronage Capital	366,671,229	378,650,152
Other Equities	131,462,672	99,294,991
Total Equities	$ 508,868,432	$ 488,273,665
LONG-TERM DEBT		
Mortgage Bonds less Current Maturities	$ 415,355,000	$ 439,037,000
CFC Mortgage Notes less Current Maturities	216,645,843	221,157,908
Total Long-Term Debt	$ 632,000,843	$ 660,194,908
ACCUMULATED PROVISION FOR PENSIONS AND BENEFITS	$ 126,472,652	$ 99,153,036
CURRENT LIABILITIES		
Current Maturities of Long-Term Debt	$ 28,194,069	$ 26,520,459
Purchased Power - Payable and Accrued	53,826,069	49,055,176
Accounts Payable - Other	26,010,886	16,575,693
Power Cost Adjustments - Over-Recovered		1,168,414
Tax Payable	8,278,302	8,546,107
Interest Payable	4,337,949	4,540,412
Member Deposits	5,563,618	4,816,072
Other Current and Accrued Liabilities	4,288,229	4,118,449
Total Current Liabilities	$ 130,499,122	$ 115,340,782
DEFERRED CREDITS	$ 16,874,727	$ 11,250,934
TOTAL EQUITIES AND LIABILITIES	$ 1,414,715,776	$ 1,374,213,325

See accompanying notes to financial statements.

PEDERNALES ELECTRIC COOPERATIVE, INC.

STATEMENT OF INCOME AND PATRONAGE CAPITAL
FOR THE YEARS ENDED DECEMBER 31, 2014 AND 2013

	December 31, 2014 Amount	December 31, 2013 Amount
OPERATING REVENUES		
Residential	$ 447,503,383	$ 406,459,902
Small Power	67,221,343	61,893,715
Industrial	9,721,872	9,183,731
Large Power	83,117,374	72,596,186
Public Authorities	763,197	670,039
Other Operating Revenues	29,161,259	29,310,965
Unbilled Revenue	(928,800)	4,938,900
Power Cost Adjustment	(14,070,174)	12,305,080
Total Operating Revenues	$ 622,489,454	$ 597,358,518
OPERATING EXPENSES		
Purchased Power	$ 385,003,269	$ 343,552,629
Transmission - Operation	1,044,586	901,751
Transmission - Maintenance	1,987,323	1,795,575
Distribution - Operation	32,544,525	30,472,953
Distribution - Maintenance	16,479,517	15,319,275
Consumer Accounts	24,938,133	27,473,081
Customer Service and Information	3,401,558	3,246,883
Sales	900,259	1,098,472
Administrative and General	27,254,620	27,290,904
Depreciation	51,905,921	50,539,821
Taxes	5,666,605	7,023,188
Other Deductions	422,861	508,218
Total Operating Expenses	$ 551,549,177	$ 509,222,750
OPERATING MARGINS - Before Fixed Charges	$ 70,940,277	$ 88,135,768
FIXED CHARGES		
Interest and Amortization on Long-Term Debt	$ 39,346,673	$ 40,925,829
Interest Charged to Construction	(591,048)	(1,565,848)
	$ 38,755,625	$ 39,359,981
OPERATING MARGINS - After Fixed Charges	$ 32,184,652	$ 48,775,787
Capital Credits	985,866	1,390,952
NET OPERATING MARGINS	$ 33,170,518	$ 50,166,739
NON-OPERATING MARGINS		
Interest and Dividend Income	$ 306,046	$ 342,476
Misc. Non-Operating Income	149,504	194,500
Gain/(Loss) on Disposal of Assets	(485,341)	63,628
	$ (29,791)	$ 600,604
NET MARGINS	$ 33,140,727	$ 50,767,343
COMPREHENSIVE INCOME	$ 33,140,727	$ 50,767,343
PATRONAGE CAPITAL - BEGINNING OF YEAR	378,650,152	370,788,042
Patronage Capital Retired	(12,857,119)	(12,328,126)
Transfers to Other Equities	(32,262,531)	(30,577,107)
PATRONAGE CAPITAL - END OF YEAR	$ 366,671,229	$ 378,650,152

See accompanying notes to financial statements.

PEDERNALES ELECTRIC COOPERATIVE, INC.

STATEMENT OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2014 AND 2013

	December 31, 2014	December 31, 2013
CASH FLOWS FROM OPERATING ACTIVITIES		
Net Margins	$ 33,140,727	$ 50,767,343
Adjustments to Reconcile Net Margins to Net Cash Provided by Operating Activities		
Depreciation and Amortization Charged to Expense	52,292,020	50,933,953
Provision for Uncollectible Accounts	615,210	628,729
Capital Credits	(985,866)	(1,390,952)
Deferral/Accrual/Asset Activity for Pension/Post-Retirement Plans	11,978,274	16,038,521
Payments on Post-Retirement Benefits	(1,864,800)	(1,613,527)
Payments to Defined Benefit Plan	(14,390,000)	(10,578,240)
Changes in Assets and Liabilities:		
Accounts Receivable - Net	1,728,273	(5,272,876)
Accrued Unbilled Revenue	928,800	(4,938,900)
Materials & Supplies	(4,880,771)	(1,644,069)
Prepayments & Other Current Assets	(755,275)	(211,936)
Deferred Charges & Other Assets	11,763,552	(12,210,639)
Accrued & Accounts Payable	6,716,209	18,775,126
Member Deposits	747,546	1,023,051
Accrued Taxes	(267,805)	913,613
Accrued Interest	(202,463)	(153,187)
Other Current Liabilities	366,134	128,243
Other Deferred Credits & Liabilities	6,169,682	6,324,486
Net Cash Provided by Operating Activities	$ 103,099,447	$ 107,518,739
CASH FLOWS FROM INVESTING ACTIVITIES		
Net Additions to Property, Plant & Equipment	$ (90,805,965)	$ (71,418,433)
Capital Credit Retirements from Associated Organizations	861,689	1,455,826
Net Cash Used in Investing Activities	$ (89,944,276)	$ (69,962,607)
CASH FLOWS FROM FINANCING ACTIVITIES		
Payments on Long-Term Debt	$ (26,520,455)	$ (24,762,289)
Retirement of Patronage Capital	(12,857,119)	(12,328,126)
Transfers to Other Equities	(94,852)	
Increase in Memberships - Net	406,009	338,063
Net Cash Used in Financing Activities	$ (39,066,417)	$ (36,752,352)
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	$ (25,911,246)	$ 803,780
CASH AND CASH EQUIVALENTS - BEGINNING OF YEAR	62,703,927	61,900,147
CASH AND CASH EQUIVALENTS - END OF YEAR	$ 36,792,681	$ 62,703,927
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION		
Cash Paid During the Year for:		
Interest on Long-Term Debt	$ 39,155,024	$ 40,692,298
Patronage Capital Retired by Noncash Discounting	$ 32,262,531	$ 30,577,107

See accompanying notes to financial statements.

NOTES TO FINANCIAL STATEMENTS

1. Nature of Operations and Summary of Significant Accounting Policies

Nature of Operations

Pedernales Electric Cooperative, Inc. (the Cooperative) is a non-profit corporation organized to provide electric service at the retail level to primarily residential and commercial accounts in a designated service area. As of December 31, 2014, the Cooperative served approximately 264,800 meters.

Power delivered at retail is purchased wholesale from the Lower Colorado River Authority (LCRA) and American Electric Power (AEP). Any revenues earned in excess of costs incurred are allocated to members of the Cooperative and are reflected as patronage capital on the balance sheet.

Regulatory Accounting

The Cooperative utilizes the Uniform System of Accounts established by the Rural Utilities Service (RUS). In accordance with Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 980, Regulated Operations, the Cooperative records certain assets and liabilities in accordance with the economic effects of the rate making process.

Utility Plant

Plant is stated at the original cost of construction which includes the cost of contracted services, direct labor, materials, and overhead items. Contributions from others toward the construction of electric plant are credited to the applicable plant accounts.

When property, which represents a retirement unit, is replaced or removed, the average cost of such property as determined from the continuing property records is credited to electric plant and such cost, together with cost of removal less salvage, is charged to the accumulated provision for depreciation.

Maintenance and repairs, including the renewal of minor items of plant not comprising a retirement unit, are charged to the appropriate maintenance accounts, except that repairs of transportation and service equipment are charged to clearing accounts and redistributed to operating expense and other accounts.

Cash and Cash Equivalents

For purposes of the statement of cash flows, cash and short-term investments are considered cash and cash equivalents.

Accounts Receivable

In the normal course of business the Cooperative recognizes accounts receivable for energy delivered and billed. The Cooperative allows 16 days from the statement date for payment to be received or the service is considered delinquent.

The Cooperative provides an allowance for uncollectible accounts to recognize the portion of receivables considered uncollectible. The allowance is estimated based on historical trends, aging of receivables, and review of potential bad debts. Accounts remaining unpaid 120 days after the due date of the final bill are written off.

Unbilled Revenue

At December 31, 2014 and 2013 the Cooperative had $25,475,400 and $26,404,200 of unbilled revenue consisting of its revenue accrued for power delivered but not billed and its revenue accrued attributable to purchased power.

Materials and Supplies Inventory

Materials and supplies inventories are valued at average unit cost.

Electric Revenues

The Cooperative records electric revenues as billed to customers on a monthly basis. Revenue is accrued for power delivered but not billed at the end of each month.

The Cooperative's tariffs for electric service include adjustment clauses under which billings to customers are adjusted to reflect changes in the cost of purchased power. In order to match power cost and related revenues these amounts to be billed to consumers in subsequent periods are included with the revenue accrual described above.

The Cooperative reduced the delivery charge component of the tariffs for electric service in December 2014. The reduction resulted in a 5 mil ($0.005) decrease in the delivery charge.

Federal Income Taxes

The Cooperative is exempt from federal income taxes under Section 501(c)(12) of the Internal Revenue Code. More than 85% of the gross income is collected from members.

The Cooperative follows the “uncertain tax positions” provisions of accounting principles generally accepted in the United States of America. The primary tax position of the Cooperative is its filing status as a tax exempt entity. The Cooperative determined that it is more likely than not that its tax positions will be sustained upon examination by the Internal Revenue Service (IRS) and that all tax benefits are likely to be realized upon settlement with taxing authorities.

The Cooperative files income tax returns in the U.S. federal jurisdiction. The Cooperative is no longer subject to examinations by federal taxing authorities for years before 2011. In 2014 and 2013, the Cooperative did not incur tax related interest or penalties.

Group Concentration of Credit Risk

The Cooperative's headquarters facility is located in Johnson City, Texas. The service area extends into 24 counties in the Central Texas region. The Cooperative records a receivable for electric revenues as billed on a monthly basis. The Cooperative may require a deposit from new members upon connection which is applied to unpaid bills and fees in the event of default. The deposit accrues interest annually and is returned to residential accounts along with accrued interest after one year of prompt payments. As of December 31, 2014 and 2013, deposits on hand totaled $5,563,618 and $4,816,072, respectively.

The Cooperative maintains its cash balances in institutions insured by the Federal Deposit Insurance Corporation (FDIC). Pursuant to legislation enacted in 2010, the FDIC fully insured all noninterest-bearing transaction accounts beginning December 31, 2010 through December 31, 2012. Beginning January 1, 2013, noninterest-bearing transaction accounts are now subject to the $250,000 limit on FDIC insurance per covered institution. The cash balances exceeded applicable insurance coverage at times during 2014 and 2013.

Patronage Capital Certificates

Patronage capital from associated organizations is recorded at the stated amount of the certificate.

Defined Benefit Plan and Other Post-Retirement Benefits

The Cooperative has a defined benefit (pension) plan for employees meeting eligibility requirements. In 2005, the pension was amended to close entry to new participants after January 1, 2006. The benefit is based on years of service and the average of the employee’s highest 36 months of compensation.

The Cooperative also sponsors a health care plan for retirees who satisfy eligibility requirements. The cost of the Cooperative’s obligation is actuarially determined based on certain weighted-average assumptions.

Use of Estimates in the Preparation of Financial Statements

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Reclassifications and Comparative Information

Some 2013 amounts have been reclassified to be consistent with the 2014 amounts.

2. Assets Pledged

Substantially all assets are pledged as security for the long-term debt due to Bank of New York (BONY) and National Rural Utilities Cooperative Finance Corporation (CFC).

3. Utility Plant

The major classes of utility plant are as follows:

	December 31, 2014	December 31, 2013
Transmission Plant	$ 98,720,311	$ 94,482,651
Distribution Plant	1,204,977,381	1,166,661,878
General Plant	139,855,112	135,282,262
Total Utility Plant in Service	$ 1,443,552,804	$ 1,396,426,791
Construction Work in Progress	53,561,428	38,516,167
Total Utility Plant	$ 1,497,114,233	$ 1,434,942,958

Provision for depreciation of utility plant is computed using straight-line rates as follows:

Transmission Plant	2.75%
Distribution Plant	2.05% - 20.00%
General Plant	2.50% - 20.00%

Depreciation for the years ended December 31, 2014 and 2013, was $54,935,826 and $53,623,102, respectively, of which $51,905,921 and $50,539,821 was charged to depreciation expense and $3,029,905 and $3,083,281 was allocated to other accounts.

4. Investments in Associated Organizations

Investments in associated organizations consisted of:

	December 31, 2014	December 31, 2013
CFC		
Capital Term Certificates	$ 4,887,296	$ 4,887,296
Patronage Capital	3,237,783	2,849,994
Texas Electric Cooperative		
Patronage Capital	3,132,282	3,384,207
Other	177,530	189,217
	$ 11,434,891	$ 11,310,714

5. Materials and Supplies Inventory

Materials and supplies inventories consist of construction materials and supplies. The ending balances for materials and supplies at December 31, 2014 and 2013 were $27,433,715 and $22,552,944, respectively.

6. Deferred Charges and Other Assets

Deferred charges and other assets included the following:

	December 31, 2014	December 31, 2013
Regulatory Asset - Defined Benefit Plan	$ 56,059,210	$ 25,008,957
Unamortized Debt Issuance Costs	3,935,471	4,321,570
Regulatory Asset - LCRA FPCRF	273,863	18,180,512
Regulatory Asset - GIS Inventory	3,756,444	-
Regulatory Asset - Facility Costs	2,008,646	-
Regulatory Asset - Software Implementation	397,826	-
LCRA Radio Services	1,242,989	1,459,161
	$ 67,674,449	$ 48,970,200

The Cooperative recognizes a regulatory asset for the portion of its pension and other post-retirement benefit plans that has not been recognized as a component of net periodic pension and other post-retirement benefit costs. Accordingly, no amounts have been recorded in other comprehensive income. The unrecognized portion is being amortized into pension and other post-retirement benefit costs over the average future service of current active plan participants expected to receive benefits.

Costs incurred with respect to the issuance of bonds have been capitalized and are being amortized over the terms of the bonds.

The LCRA fuel & power cost recovery factor (FPCRF) represents the amount that the Cooperative will be billed by LCRA in future periods for electricity previously purchased. Since this amount will be collected from members in the future through the power cost adjustment (PCA), it is classified as a regulatory asset. A corresponding liability is also recorded for the same amount.

The GIS Inventory regulatory asset represents the deferral of costs incurred by the Cooperative in performing a GPS survey and field inventory of the transmission and distribution system. The deferral of the cost through the ratemaking process was approved by the Cooperative's Board of Directors and will be recovered over a period of 20 years.

The Facility Costs regulatory asset represents the deferral of the facility repair expenses that were incurred as a result of the Facility Assessment Study. The Study recommended significant and costly repairs and renovations to the Cooperative's facilities. The deferral of the cost through the ratemaking process was approved by the Cooperative's Board of Directors and will be recovered over a period of 10 years.

The Software Implementation regulatory asset represents the deferral of costs associated with implementing software. The deferral of the cost through the ratemaking process was approved by the Cooperative's Board of Directors and will be recovered over a period of five years.

The Cooperative has an agreement in place to utilize LCRA's trunked radio system in the Junction district. The associated costs were paid upon initiation of the agreement. The costs have been capitalized and are being amortized over the contract term, which ends in August 2020.

7. Patronage Capital

Patronage capital represents the Cooperative's accumulated retained net margins that have been allocated annually to its members. Distributions to members are made at the discretion of the Board of Directors in accordance with the Bylaws, subject to the covenants contained in the long-term debt agreements.

The loan agreements contain provisions that must be met for the Cooperative to make patronage capital retirements. These provisions include maintaining debt service coverage ratios of 1.15 for the BONY bonds and 1.35 for CFC debt. The Cooperative is in compliance with these provisions at December 31, 2014 and 2013.

Under certain circumstances, the Board of Directors may choose to retire patronage capital earlier than the Cooperative's current approximate 30-year retirement schedule. In these instances, the Cooperative retires and pays the net present value of patronage capital to a member or former member before the time the Cooperative anticipates normally retiring and paying patronage capital.

Patronage capital totaling $12,857,119 and $12,328,126 was distributed to members during 2014 and 2013, respectively.

Patronage capital assigned and assignable at December 31, 2014 and 2013, is as follows:

	December 31, 2014	December 31, 2013
Assigned to date	$ 519,340,309	$ 473,606,716
Assignable	59,544,928	72,232,644
	$ 578,885,237	$ 545,839,360
Less: Retirements to date	80,751,336	67,894,217
Less: Discounted Patronage Capital to Permanent Equity	131,462,672	99,294,991
	$ 366,671,229	$ 378,650,152

The Cooperative's Bylaws provide that amounts received by the Cooperative in excess of costs and expenses shall, insofar as permitted by law, (a) be used to offset any losses incurred during the current or any prior fiscal year and, (b) to the extent not needed for that purpose, be allocated to its members on a patronage basis.

8. Long-Term Debt

At December 31, 2014 and 2013, long-term debt consisted of the following:

	December 31, 2014	December 31, 2013
Senior Mortgage Bonds, Series 1993; 8.55%; due 2020 interest payable semi-annually on May 15 and November 15; principal payments begin 2017	$ 65,000,000	$ 65,000,000
Senior Mortgage Bonds, Series 1993; 8.85%; due 2016 interest payable semi-annually on May 15 and November 15; principal payments begin 2015	$ 15,000,000	$ 15,000,000
First Mortgage Bonds, 1995 Series A; 7.55%; due 2015 interest payable semi-annually on May 15 and November 15; principal payments began 1996	$ 10,862,000	$ 22,640,000
First Mortgage Bonds, 2002 Series A; 5.952%; due 2022 interest payable semi-annually on May 15 and November 15; principal payments began 2013	$ 108,675,000	$ 119,075,000
First Mortgage Bonds, 2002 Series A; 6.202%; due 2032 interest payable semi-annually on May 15 and November 15; principal payments begin 2023	$ 239,500,000	$ 239,500,000
CFC Loan; 3.85%; due 2043 interest and principal payable quarterly principal payments began 2012	$ 221,157,912	$ 225,500,367
	$ 660,194,912	$ 686,715,367
Less: Current Maturities	28,194,069	26,520,459
Total long-term debt	$ 632,000,843	$ 660,194,908

Annual maturities of long-term debt for the next five years and thereafter are as follows:

2015	$ 28,194,069
2016	29,563,308
2017	31,526,430
2018	33,651,705
2019	36,014,413
Thereafter	501,244,987

The Cooperative has an aggregate of $270,000,000 in long-term loan funds available for advance from CFC, which are available through November 21, 2019 subject to the terms, conditions, and provisions of the loan agreement. Within the aggregate amount are five separate notes that were issued; however, the Cooperative may request any amount provided that such amount does not exceed $270,000,000 and such debt would have a maturity date of no later than November 21, 2054.

In 2015, the Cooperative anticipates executing a loan agreement with CoBank for an aggregate debt facility of up to $250,000,000.

9. Short-Term Borrowing

The Cooperative has a line of credit at a variable interest rate with CFC not to exceed $100,000,000. There was no balance outstanding at December 31, 2014 and 2013. The line of credit agreement requires the Cooperative to pay down the balance to zero annually and automatically renews unless either party gives a 90-day notice.

10. Deferred Credits

Deferred credits include the following:

	December 31,	
	2014	2013
Patronage Capital - Pre-Escheat	$ 7,745,775	$ 5,489,620
Contributions in Aid of Construction	4,414,309	4,151,734
Regulatory Liability - LCRA FPCRF	3,653,403	-
Post-Retirement Medical Benefits Regulatory Liabil	1,037,242	1,583,131
Unclaimed Property Payable	23,998	26,449
	$ 16,874,727	$ 11,250,934

The patronage capital pre-escheat component represents unclaimed patronage capital checks that do not meet escheat criterion. The liability is recorded as unclaimed patronage capital checks are voided. As the funds are claimed or reach escheat status, the liability is reduced.

The contributions in aid of construction component represents funds received for construction projects.

During 2014 and 2013, the Cooperative realized a gain for post-retirement medical benefits. The Cooperative recognized a regulatory liability for the net amount of the unrecognized gain.

11. LCRA Fuel & Power Cost Recovery Factor (FPCRF)

The Fuel and Power Cost Recovery Factor represents over or under-recovered cost adjustments for electricity purchased from LCRA. During 2014, there were two components of the FPCRF that were recorded. The amount under-recovered by LCRA as of June 30, 2014 was recorded separately from the adjustments that occurred from July 1, 2014 – December 31, 2014.

The amount under-recovered by LCRA as of June 30, 2014 was partially collected from members through the power cost adjustment (PCA). The Cooperative elected to forego collection of the remaining portion, which totaled $21,476,260. As of December 31, 2014, there is a liability recorded for the remaining balance to be remitted to LCRA in 2015, which totaled $24,101,039.

The FPCRF activity that occurred from July 1, 2014 – December 31, 2014 represents an over-recovery by LCRA of $3,653,403, which is classified as a receivable on the balance sheet.

12. Commitments and Contingencies

Power Supply Contracts

The Cooperative entered into contracts for the purchase and delivery of electric energy to satisfy its electric energy requirements. In 2014 and 2013, the Cooperative purchased energy from the Lower Colorado River Authority (LCRA) and American Energy Partners (AEP). LCRA was the primary wholesale electric energy supplier, while AEP supplied electric energy to serve a portion of the electric energy requirements for the Cooperative's delivery points within LCRA's service territory and the full electric energy requirements for delivery points outside of LCRA's service territory. All of the electric energy purchased by the Cooperative is procured through term contracts of varying durations. As these terms expire, they may or may not be replaced with new agreements.

Transmission Lease Contracts

LCRA leases and operates certain transmission facilities and equipment owned by the Cooperative. Payments for the leased facilities vary from year to year and are based on the original cost of the facilities, adjusted for depreciation, and are updated annually to reflect additions, retirements and depreciation. The terms of the lease are perpetual, but may be terminated by LCRA or the Cooperative upon five years written notice. The Cooperative's transmission lease revenues totaled approximately $5,168,573 and $5,201,891 in 2014 and 2013, respectively.

Litigation

The Cooperative may be involved in various claims and litigation arising in the normal course of business. Although management is unable to predict the outcome of such proceedings, management and the Cooperative's legal counsel do not believe that the resolution of any claims or litigation involving the Cooperative will have a material adverse effect on the Cooperative's results of operations and financial condition.

13. Pension Benefits

The Cooperative has a defined benefit plan covering eligible employees. The cost of the plan is determined by an independent actuary and is funded in amounts sufficient to meet the minimum funding requirements under applicable regulations.

Contributions paid to the defined benefit plan for the years ended December 31, 2014 and 2013, were $14,390,000 and $10,578,240, respectively.

The measurement date used for the current valuation is December 31, 2014.

The following weighted-average assumptions were used to develop the accumulated post-retirement benefit obligation for 2014 and 2013:

	2014	2013
Discount Rate	4.10%	4.85%
Rate of Compensation Increase	4.16%	3.79%

The following weighted-average assumptions were used to determine the net benefit cost for 2014 and 2013:

	2014	2013
Discount Rate	4.85%	3.80%
Rate of Compensation Increase	3.79%	3.49%
Expected Long-Term Return on Plan Assets	6.50%	6.50%

Amounts recognized in the Cooperative's financial statements and funded status of the plan are as follows:

	December 31, 2014	December 31, 2013
I) Net Periodic Benefit Cost		
Service Cost	$ 4,424,504	$ 4,816,959
Interest Cost	8,525,762	7,149,538
Amortization	2,207,332	5,525,366
Return on Assets	(9,154,893)	(7,699,410)
	$ 6,002,705	$ 9,792,453
II) Projected Benefit Obligation (PBO) Reconciliation:		
PBO Balance at Beginning of Year	$ 168,900,397	$ 191,423,813
Actuarial (Gain)/Loss	30,760,007	(27,464,553)
Interest Cost / Service Cost	12,950,266	11,966,497
Benefits Paid	(7,025,677)	(7,025,360)
Projected Benefit Obligation at Year End	$ 205,584,993	$ 168,900,397
III) Reconciliation of Funded Status		
Projected Benefit Obligation	$ 205,584,993	$ 168,900,397
Fair Value of Assets	153,867,803	139,846,165
Funded Status at Year End	$ (51,717,190)	$ (29,054,232)
IV) Accumulated Other Comprehensive Loss		
Actuarial Loss - Beginning of Year	$ 25,008,957	$ 68,141,712
Amortization of Loss/Remeasurement	(2,207,332)	(5,525,366)
Actuarial (Gain)/Loss	33,257,585	(37,607,389)
Other Comprehensive Loss	$ 56,059,210	$ 25,008,957

The accumulated benefit obligation for the plan was $181,861,826 and $152,785,831 at December 31, 2014 and 2013, respectively.

Plan Asset Information

Information related to fair value hierarchy measurements are disclosed in Footnote 15. The defined benefit plan asset fair value measurements are substantially Level 1.

Fair value of plan assets at December 31, 2014 and 2013 and asset allocation follows:

	December 31, 2014	December 31, 2013
Cash and Cash Equivalents	$ 4,281,939	$ 5,790,893
Pooled, Common and Collective Funds	-	7,765,476
Government Agencies, Bonds and Notes	58,019,262	12,841,800
Mutual Funds	78,058,878	113,447,996
Other	13,507,724	-
Total	$ 153,867,803	$ 139,846,165

	December 31, 2014	December 31, 2013
Mutual Funds and Equity Securities	51%	87%
Debt Securities	38%	9%
Other	11%	4%
Total	100%	100%

Benefit payments for the next 10 years are estimated as follows:

2015	$ 7,629,382
2016	7,964,793
2017	8,276,340
2018	8,576,747
2019	8,854,392
2020-2024	50,923,442

The estimated 2015 plan year minimum required contribution is $10,500,000.

The Cooperative has a defined contribution plan (401(k) plan) for employees that are eligible to participate. For employees that are also eligible to participate in the defined benefit plan, the maximum contribution is six percent of the employee's base annual salary. For employees not eligible for the defined benefit plan, the 401(k) plan contribution cost is a maximum of 10% of the employee's base annual salary. These costs are funded each pay period as accrued. The Cooperative's contributions to the 401(k) plan (net of forfeitures) were $3,270,717 and $3,086,624 in 2014 and 2013, respectively.

14. Post-Retirement Benefits Other than Pensions

The Cooperative provides post-retirement medical benefits for eligible employees through a plan with a third-party insurance provider. For purposes of this statement, the written plan in effect is the substantive plan and is considered a defined benefit plan. The Cooperative contributes varying amounts dependent on retirement date, age, and years of service.

Benefits are paid on behalf of retirees and are a function of medical insurance costs and number of retirees. Benefits paid for the years ended December 31, 2014 and 2013, were $2,117,405 and $1,980,403, respectively.

The Cooperative's policy for contributions is to contribute the amount of the current benefits in that year.

The measurement date used for the current valuation is December 31, 2014.

The weighted-average discount rate used to develop the accumulated post-retirement benefit obligation for the years ended December 31, 2014 and 2013, were 4.12% and 4.85%, respectively. The assumed health care cost trend rate is nine percent for 2013, declining to an ultimate level of 5% in 2021.

Amounts recognized in the Cooperative's financial statements and funded status of the plan are as follows:

	December 31, 2014	December 31, 2013
I) Net Post-Retirement Benefit Cost		
Service Cost	$ 1,323,302	$ 1,610,000
Interest Cost	3,282,722	3,140,000
Amortization	1,369,545	1,592,482
	$ 5,975,569	$ 6,342,482
II) Accumulated Post-Retirement Benefit Obligation (APBO) Reconciliation:		
APBO Balance at Beginning of Year	$ 70,098,804	$ 80,682,488
Actuarial (Gain)/Loss	1,915,434	(13,623,743)
Interest Cost / Service Cost	4,606,024	4,750,000
Benefits Paid	(1,864,800)	(1,709,941)
Net Post-Retirement Benefit Liability at Year E	$ 74,755,462	$ 70,098,804
III) Reconciliation of Funded Status		
APBO	$ 74,755,462	$ 70,098,804
Accrued Post-Retirement Benefit Cost	$ 74,755,462	$ 70,098,804
IV) Accumulated Other Comprehensive Loss		
Actuarial Loss (Gain) - Beginning of Year	$ (1,583,131)	$ 13,633,094
Amortization of Loss/Remeasurement	1,369,545	1,592,482
Current Year Net (Gain)/Loss	1,915,434	(13,623,743)
Other Comprehensive (Gain) Loss	$ (1,037,242)	$ (1,583,131)

The estimated actuarial loss for the post-retirement medical benefit plan that will be amortized from accumulated other comprehensive income into net post-retirement benefit cost over the next fiscal year is expected to be $610,494.

The Cooperative has not funded any plan assets as of December 31, 2014 or 2013.

Estimated future benefit payments for the next 10 years are as follows:

2015	$ 2,610,165
2016	2,749,178
2017	2,949,113
2018	3,199,872
2019	3,508,427
2020-2024	21,083,953

15. Disclosures About Fair Value of Financial Instruments

Many of the Cooperative's financial instruments lack an available market with similar terms, conditions, and maturities as those reflected in the carrying amount recorded. Accordingly, significant assumptions, estimations, and present value calculations were used for purposes of this disclosure.

Estimated Fair Value has been determined by calculating the present value of financial instruments using the best data available.

Fair Value for some amounts carried on the financial statements has not been calculated for the following reasons:

Patronage Capital from Associated Organizations – The right to receive cash is an inherent component of a financial instrument. The Cooperative holds no right to receive cash since any payments are at the discretion of the governing body for the associated organizations. As such, Patronage Capital from Associated Organizations is not considered financial instruments.

CFC Capital Term Certificates and Member Capital Securities – It is not practicable to estimate fair value for these financial instruments given the lack of a market and their long holding period. Relevant information with respect to these is as follows:

AMOUNT	INTEREST RATE	MATURITY
$ 960,968	3.00%	2020-2030
1,715,690	-	2043
2,210,638	5.00%	2070-2080

Cash and Short-Term Investments – The recorded book value approximates fair value given the short period to maturity.

Long-Term Debt - Estimated by computing the present value by individual note to maturity, using currently quoted or offered rates for similar issues of debt. The year-end CFC fixed interest rate for long-term debt was used in the calculation for all fixed rate long-term debt. These are the only financial instruments of the Cooperative that have a difference in Fair Value and Carrying Value.

The carrying values of the Cooperative's financial instruments and debt and the estimated fair values are as follows:

	December 31, 2014		December 31, 2013	
	CARRYING VALUE	FAIR VALUE	CARRYING VALUE	FAIR VALUE
Assets:				
Cash and Cash Equivalents	$ 36,792,681	$ 36,792,681	$ 62,703,927	$ 62,703,927
Short-Term Investments	14,000,000	14,000,000	14,000,000	14,000,000
Long-Term Investments	-	-	-	-
Patronage Capital and				
Capital Term Certificates	11,434,891	11,434,891	11,310,714	11,310,714
Liabilities:				
Long-Term Debt	660,194,912	635,917,084	686,715,367	645,113,653

Fair Value Hierarchy

The Fair Value Measurements Topic of the FASB Accounting Standards Codification establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to measurements involving significant unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy are as follows:

Level 1 - inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the Cooperative has the ability to access at the measurement date.

Level 2 - inputs are inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly.

Level 3 - inputs are unobservable inputs for the asset or liability.

Long-Term Debt valuations are considered Level 2.

16. Subsequent Events

The Cooperative has evaluated subsequent events through April 1, 2015, the date which the financial statements were available to be issued.

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LETTER TO BOARD OF DIRECTORS REGARDING POLICIES CONCERNING AUDITS OF CFC BORROWERS

Board of Directors
Pedernales Electric Cooperative, Inc.
Johnson City, Texas

We have audited, in accordance with auditing standards generally accepted in the United States of America, the balance of Pedernales Electric Cooperative, Inc. as of December 31, 2014 and 2013, and the related statements of income and patronage capital and cash flows for the years ended, and have issued our report thereon dated April 1, 2015.

In connection with our audit, nothing came to our attention that caused us to believe that the Cooperative failed to comply with the terms of Article V of the National Rural Utilities Cooperative Finance Corporation Loan Agreement insofar as they relate to accounting matters. However, our audits were not directed primarily toward obtaining knowledge of such incompliance.

This report is intended solely for the information and use of the Boards of Directors and management of Pedernales Electric Cooperative, Inc. and the National Rural Utilities Cooperative Finance Corporation and is not intended to be and should not be used by anyone other than these specified parties.

Bolinger, Segars, Gilbert & Moss LLP

Certified Public Accountants

Lubbock, Texas

April 1, 2015