

economic impacts

The economic and business success of our family of companies is inextricably tied to the economic success and sustainability of the communities that we serve. That is why Pinnacle West is so active in the community. We have a commitment to bettering the state's economic and social vitality by being active in economic development, through community and business leadership, volunteerism, education, environmental stewardship and charitable giving.

Pinnacle West has a tremendous economic impact on the communities we serve, including:

- Our product, electricity, is essential to economic growth and a functional economy. Our customers rely on us to provide efficient and reliable electrical service so that they can live, work and grow their businesses
- Pinnacle West is a major employer in Arizona, and one of a relatively few S&P 500 companies with headquarters in Arizona
- APS is essentially one of the largest construction companies in Arizona due to the extensive construction of new substations, distribution and transmission lines, power plants and other infrastructure necessary to both maintain our system and to grow our system to meet the rapid growth of our customers
- Affiliate SunCor is a major developer in commercial and residential projects
- Pinnacle West's economic development efforts are a major contributor to economic growth in Arizona. We are somewhat unique in that our economic development efforts extend to all areas of the state, including rural areas, rather than just focusing in on the major metropolitan areas
- Pinnacle West's Supplier Diversity Program has provided a significant benefit to the development of a diverse supplier network in Arizona
- Our extensive network of power plants, transmission and distribution lines, offices and support facilities provides a great deal of property tax dollars to the areas we are located. For example, the Palo Verde Nuclear Generating Station is the largest single commercial taxpayer in Arizona

In this report, we also provide financial details on issues such as spending on minority- and women-owned businesses, and charitable donations, and have a detailed discussion on climate change which may have future economic impacts

Financial Performance

At Pinnacle West, we believe financial success is an integral component in the concept of sustainability. Smart investors and consumers alike are finding that the other two pillars of sustainability — environmental and social performance — can impact a company's bottom line. At the same time, financial success provides us with the ability to financially support leadership efforts in environmental and social performance.

We firmly believe that responsible and sustainable business practices translate into strong financial performance. Whether it is our practice of selling coal ash waste streams rather than disposing of them, having an aggressive investment recovery program, improving efficiencies in our generating units in order to reduce costs and emissions, or improving our community through volunteerism and charitable giving, these actions lead to a sustainable and profitable long-term business.

We provide specific financial details on issues such as spending on minority- and women-owned businesses, and charitable donations in the Community and Suppliers sections of this report. We also provide a detailed discussion on climate change which may have future economic impacts. These are a few of the examples of our efforts to improve our success and increase shareholder value through sustainable business practices.

Detailed information on PNW's 2006 financial performance is found at our website at www.pinnaclewest.com

Economic Development

One of the tenants of sustainability is economic development. We realize that in order for our enterprise to be successful, the state's business community must remain robust. That is why our company places such stock in economic development. APS works with partners throughout the state to help bring quality manufacturing and financial services jobs to Arizona.

Our role is to foster healthy economic development in our communities to create vibrant, sustainable communities in our service territory, with a special emphasis on our rural areas. To help Arizona communities retain successful hometown companies and encourage them to create more jobs, APS sponsoring the Building Bridges to Business program, or B3. This Internet-based program provides communities and their economic development organizations with sophisticated survey instruments and customized computer software that help define, analyze and report community-specific company information.

APS' Focused Future economic development programs have helped Arizona communities boost their local economies for the past decade, and in 2002 earned APS a national innovation award from the National Association of Development Organizations. The program has helped dozens of Arizona communities capitalize on the economic development strengths that are unique to each of them. APS benefits directly when these communities thrive and grow.

In 2006, APS' Business Development team worked with our economic development partners to locate eight new companies in our service territory, creating an estimated 2,067 new jobs, new electrical load of 31.2 megawatts (MW), capital investments of \$170 million and 1,360,000 square feet of building space.

APS' partners include the Arizona Department of Commerce (ADOC), the Greater Phoenix Economic Council (GPEC), as well as all of the rural Economic Development Departments in our Arizona communities (such as Casa Grande, Yuma, Prescott, Prescott Valley, Payson, Flagstaff, Globe and Parker).

These are some of the things APS does to help foster economic development:

- APS offers its economic development Web site, Explore Arizona, which provides Arizona demographic information and information on available buildings in rural communities and has now created an updated tool called Arizona Prospector www.arizonaprosector.com to help find land, buildings, and demographics with a GIS integrated system
- APS provides electric rate analysis and infrastructure evaluations for prospective companies
- APS assists its partners with site visits from site selectors and facility managers, and - on occasion for the larger companies - a helicopter tour to help them get a better perspective of transportation routes and other factors
- APS helps GPEC, ADOC and our rural partners with sales missions with site selectors throughout the United States
- The APS Community Initiatives team works with Arizona communities to create business plans that emphasize quality growth with quality of life as well as leadership and other programs, all to help them become vibrant, growing communities

The "Building Bridges to Business" (B3) program for the communities APS serves, using synchronistic technology to work with existing manufacturers/businesses to understand their businesses and ensure their quality growth

Electric System Reliability

Electricity is an essential component of our economy and our personal lives. That is why electric system reliability is so important to PNW. The company has numerous programs in place to help ensure the efficiency and reliability of our transmission and distribution system.

APS follows the Institute of Electrical and Electronics Engineers (IEEE) Guideline 1366 when measuring its reliability and when it benchmarks with other utilities.

IEEE 1366 defines an interruption as a loss of power for more than five minutes. Anything less than that is considered a momentary interruption. The company uses three popular measures of reliability that are defined in the IEEE Guideline. Within a one-year period, throughout the entire APS system, APS measures the:

- System Average Interruption Frequency Index (SAIFI): the total number of sustained customer interruptions divided by the total number of APS customers
- System Average Interruption Duration Index (SAIDI): the total number of sustained customer interruption minutes divided by the total number of APS customers
- Customer Average Interruption Duration Index (CAIDI): the total number of sustained customer interruption minutes divided by the total number of sustained customer interruptions

For each of these indices, the lower the number, the better.

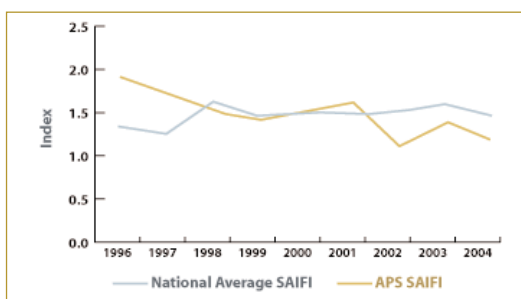
The largest reliability benchmarking effort we know of is performed by the Edison Electric Institute (EEI). In its most recent benchmarking survey, which measures reliability for 2004 and contains data from 75 utilities:

1. For SAIFI, APS was in the middle of the second quartile with a value of 1.17. The U.S. average is 1.47.
2. For SAIDI, APS was in the first quartile at 95 minutes. The U.S. average is 381 minutes.
3. For CAIDI, APS was in the first quartile at 81 minutes. The U.S. average is 187 minutes.

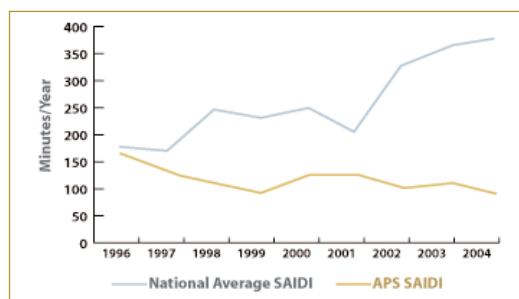
As the below graphs show, between 1996 and 2004 (the latest EEI statistics available at the time of this report), APS' System Average Interruption Frequency Index (SAIFI) or the average number of sustained interruptions seen by the average customer on our system, improved (lower is better) by 38%, while the national average rose (got worse) by 9%.

Similarly, the APS System Average Interruption Duration Index (SAIDI) or the average annual duration of sustained interruptions seen by the average customer on our system improved (lower is better) by 44% while the national average rose (got worse) by 109%.

SAIFI Comparison



SAIDI Comparison



TransWest Express Project

The TransWest Express Project was announced by the company in October 2005. The goal is to determine the viability of building a new transmission project from Wyoming to Arizona to provide Arizona and other southwestern states increased capability to access electricity generated from wind, coal, and other resources in the Wyoming area. In addition to providing access to energy resources for rapid growth areas in the Southwest, TransWest Express will benefit all western states by providing improved reliability of the western grid. The Phase 1 Feasibility Study is complete. Negotiations for a Participation Agreement to move forward with Phase 2 are under way with interested participants. Phase 2 would include determination of AC or DC technology, route selection, permitting, engineering, regulatory approvals, stakeholder relations and financing. Phase 2 is estimated to take up to five years to complete at a cost of \$115 million which will include options for rights of way.

The parties negotiating in the Participation Agreement are APS, SRP, Southern California Edison, Tucson Electric Power, National Grid and Wyoming Infrastructure Authority. APS and the other groups involved with TransWest are also working with various external stakeholders to address their concerns regarding potential impacts of this transmission line. APS is hopeful the Participation Agreement will be executed in the near future.

New Technologies

New technologies will be a critical factor in meeting increasing electric demands. Examples of some of the new technologies we have incorporated into our Transmission/Distribution system include:

Aluminum Conductor Composite Reinforced Transmission Line

After extensive evaluation, APS recently used 3M's aluminum conductor composite reinforced (ACCR) conductor to increase a transmission line's capacity without disrupting the surrounding community. The six-mile, 230-kV transmission line, originally built in the 1970s, was forecasted to be maxed out in capacity. This new technology allowed APS to re-conductor this transmission line with conductor weighing the same as the previous conductor, but which is able to carry more than twice the electrical power of conventional conductors of the same size, with minimal conductor sag

Online Monitors

APS is expanding its online monitoring program to all transformers and shunt reactors 230kV and above. Instead of annual manual sampling, the monitors continuously sample the transformer oil for gas levels and issue a report every four hours, using an artificial neural network system called the Transformer Oil Analysis Notification program (TOAN).

This online monitoring program allows APS to detect a problem and repair or replace a transformer before it fails, improving the reliability of the system and significantly reducing costs. The system has been tested at a 92.9 percent accuracy rate for predicting related faults in power transformers, more than double the accuracy of our previous system.

Smart Meters

New "smart meters" have the ability to send an immediate notification to the utility when the meter experiences a power outage. This significantly decreases the time for the utility to determine the device on the network that is responsible for the outage. This technology allows the utility to dispatch crews sooner to make the needed repairs, ultimately reducing the length of outages.

These "smart meters" also notify the utility once the power at the meter has been restored. Validating that 100 percent of the meters in the affected area have power restored reduces the need to re-dispatch crews to the same area to address an outage on a downstream device such as a transformer that was masked by the larger outage. This metering technology known as Advanced Metering Infrastructure (AMI) also collects much more data about each metering end point on the system. This data helps to facilitate better efficiency in the design of the network. This will reduce outages by identifying areas that need attention and addressing the need prior to overloading the system.

Here are some of the benefits the smart meters offer:

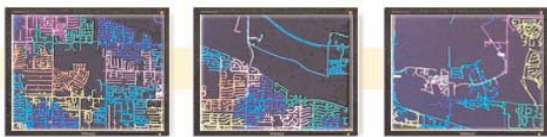
Customers will experience shorter outages

No longer will APS have to rely on calls from customers to initiate repair work since outage notifications would be instant

Smart metering technology also will help APS identify areas more susceptible to service interruptions

In January, APS passed the 20,000-unit mark in its deployment of "smart meter" technology. These intelligent meters will allow customers to dictate in real time when electricity is used, how much is used and how it is used. The initial 20,000-unit installation is part of an agreement with Tempe-based PowerOneData Inc. to provide APS with 160,000 residential meters. Through routine replacements and an existing conversion program, APS projects that its more than one million customers could be part of this smart network within five years.

"We are extremely excited to bring our level of service into the next century," said APS Vice President of Customer Service Jan Bennett. "These smart meters will allow our customers to gain more control over their energy usage. They also offer APS a diagnostic tool that in turn makes our system more reliable."



Distribution Operations Management System (DOMS)

APS prides itself on innovation and service, and the latest developments in smart meters and the company's Distribution Operations Management System (DOMS) are two cutting edge technologies which will benefit customers and APS.

APS designed the DOMS software system to replace wall maps, track outages information in real time, and manage electrical loads, construction and repair crews. Like many utilities across the country, APS relies on paper wall maps with color-coded pins to understand the big picture of its distribution electrical grid.

When completed, DOMS will allow APS to manage and track information and make updates to this grid via computer. Currently 17 percent of the DOMS project is finished, with overall completion anticipated in 2010.

While APS' traditional methods of managing electrical loads and its response to outages work well, there is a need for new technology to address the continued rapid growth of APS' service territory. The company's goal is to not only address the growth, but to remain ahead of it. The objective of the DOMS project is to improve outage communications and reliability reporting, and further reduce customer power-outage durations. Improved customer satisfaction and enhanced safety practices are just a couple of benefits that would follow.

Before DOMS can be implemented, some preparation must take place. APS is going through a process of field-phasing verification to ensure the information in the DOMS correlates to what is out in the field. In a service territory that adds, on average, 10 new distribution substations each year and more than 125 new customers each day, that's quite an undertaking.

In the long run, the overall effect of DOMS will be a mass integration of APS services and systems. This will consolidate the systems at five distribution operating centers covering about 35,000-square miles in the Phoenix metro area and four state regions into one as needed, such as after-hour operations. It also means a merging and addition of computer systems. From this, DOMS will have the potential for quickly providing planning analysis, power-flow analysis and suggested switching tools to maintain the electrical grid.

The implementation of DOMS will improve many of the ways APS does business in the future. The DOMS computer stations will be used to provide simulator training to new operators, enabling them to hit the ground running. It will affect the areas of construction, operations, maintenance, data quality and customer care. For APS crews in the field, DOMS will offer crew management and call-out tools to better monitor manpower requirements. The systems fault locator ability will also reduce the time necessary for troubleshooting to isolate faults.

APS Generation

APS owns and operates a number of power plants located across Arizona and in Farmington, NM.

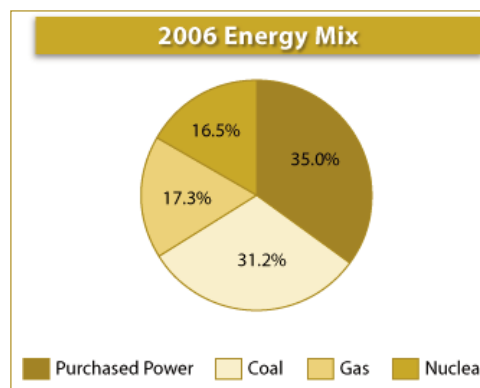
2006 Energy Mix

APS' sources of energy during 2006 are shown in the chart to the right.

Since 2003, APS has formally included environmental factors when evaluating power purchase agreements or generation assets for procurement. Environmental factors considered include air emissions of priority pollutants, carbon emissions, water consumption and source, and compliance history.

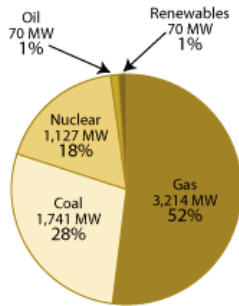
APS' owned generating facilities 2006 capacities:

Our electric generating facilities use a mix of fuels including coal, natural gas, oil and nuclear, as well as renewable sources. Having a balanced fuel mix has provided APS with a number of financial and environmental benefits. This fuel mix allows us to enter into long-term fuel-purchasing agreements with our suppliers, which reduces our costs and provides stable fuel sources into the future. In addition, it gives us operational flexibility so we can respond to changing markets and current events. Our fuel mix has been a significant factor in our ability to decrease our air emissions intensity while continuing to add generation resources to meet our rapid customer growth. This is discussed in more detail in the Air Emissions section of this report.



Capacity (kW)	
Coal	
Units 1, 2 and 3 at Four Corners	560,000
15% owned Units 4 and 5 at Four Corners	222,000
Units 1, 2 and 3 at Cholla	641,000
14% owned Units 1, 2 and 3 at the Navajo Generating Station	315,000
Subtotal	1,741,000
Gas or Oil	
Two steam units at Ocotillo and two steam units at Saguaro	430,000
Twenty-two combustion turbine units	992,000
Seven combined cycle units	1,862,000
Subtotal	3,284,000
Nuclear	
29.1% owned or leased Units 1, 2, and 3 at Palo Verde	1,126,752
Solar	
	5,816
Total	6,157,568

2006 APS Owned Generation Capacity by Fuel Type



This pie chart shows that about 10 MW (1%) of our owned generation is from renewable sources. At the end of 2006, APS had a total of 106.5 MW of renewable energy capacity, most of which comes from purchased sources under contract rather than APS owned generation. This is discussed further in the Clean Energy section of this report.

Nuclear energy is an important part of our generation mix, providing economic and environmental benefits, including significant air emissions avoidance, which is discussed further in the Climate Change section of this report.

We also remain committed to our policy of producing energy from natural resources in the most economic and efficient ways possible. We purchase approximately 97 percent of our coal locally. When feasible,

energy is produced from local and regional fuel sources in an effort to limit the economic and environmental impact of transportation.

More detail on our fuel supply and purchased power may be found in the Investors section of our Pinnacle West Web site.

Our 2006 net generation and fuel use is shown in the table below:

2006 Net Generation and Fuel Use - APS Owned Generation

	Net Generation (MWH)	Fuel Use				Total BTUS
		Coal (Tons)	Nat Gas (MCF)	Diesel (BBLS)	Resid (BBLS)	
Four Corners	5,997,506	3,568,120	146,660			63,631,842
Cholla	4,74,187	2,574,420	4,610	4,410		49,984,358
Navajo	2,403,572	1,094,720			2,297	23,357,266
Douglas	59			180		1,040
Yucca	25,942		405,900	5,040		441,523
Ocotillo	139,735		1,629,840	0	0	1,661,258
Saguaro	60,832		673,830	0	0	690,779
West Phoenix	2,057,992		3,071,360	0		3,128,021
Hydro	0					
Solar	10,137					
Palo Verde	6,987,559					
Redhawk	4,915,675		35,731,070			36,516,892
Sundance	102,999		1,001,470			1,025,967
Total	27,476,195	7,237,260	5,932,200	9,630	2,297	142,896,088