

GALLAGHER & KENNEDY

P. A.

ATTORNEYS AT LAW

MICHAEL M. GRANT
DIRECT DIAL: (602) 530-8291
E-MAIL: MMG@GKNET.COM



0000028261

2575 EAST CAMELBACK ROAD
PHOENIX, ARIZONA 85016-9225
PHONE: (602) 530-8000
FAX: (602) 530-8500
WWW.GKNET.COM

September 9, 2005

HAND DELIVERED

Docket Control
Arizona Corporation Commission
1200 W. Washington
Phoenix, AZ 85007

Re: *AEPCO Finance Order; Decision No. 68065; Docket No. E-01773A-04-0793;
Financing Documents--Compliance Item*

Dear Sir/Madam:

Pursuant to the ninth Ordering Paragraph of Decision No. 68065, attached are the original and 13 copies of the executed financing documents between AEPCO and the National Rural Utilities Cooperative Finance Corporation pertaining to this matter dated as of August 15, 2005. Pursuant to the eighth Ordering Paragraph of Decision No. 68065, a copy is also being delivered to Mr. Bozzo, Compliance Section, Utilities Division.

Very truly yours,

GALLAGHER & KENNEDY, P.A.

By: Michael M. Grant

MMG/plp
10421-39/1296960

Attachments

cc (w/attachments): Brian Bozzo, Utilities Division, Compliance Section
cc (w/o attachments): Gary Pierson
Patrick Ledger

AZ CORP COMMISSION
DOCUMENT CONTROL

2005 SEP - 9 P 3: 28

RECEIVED

LOAN AGREEMENT

LOAN AGREEMENT (this "Agreement") dated as of August 15, 2005, between ARIZONA ELECTRIC POWER COOPERATIVE, INC. (herein called the "Borrower"), a cooperative corporation organized and existing under the laws of the State of Arizona and NATIONAL RURAL UTILITIES COOPERATIVE FINANCE CORPORATION (herein called "CFC"), a corporation organized and existing under the laws of the District of Columbia.

RECITALS

WHEREAS, the Borrower has applied to CFC for a loan or a series of loans for the purposes set forth in Schedule 1 hereto and CFC is willing to make such loans to the Borrower on the terms and conditions stated herein; and

WHEREAS, the Borrower has agreed to execute one or more promissory notes to evidence an indebtedness in the aggregate principal amount of the CFC Commitment (as hereinafter defined).

NOW, THEREFORE, for and in consideration of the premises and the mutual covenants hereinafter contained, the parties hereto agree and bind themselves as follows:

ARTICLE I

DEFINITIONS

Section 1. For purposes of this Agreement, the following capitalized terms shall have the following meanings (such definitions to be equally applicable to the singular and plural forms thereof).

"Accounting Requirements" shall mean any system of accounts prescribed by a federal regulatory authority having jurisdiction over the Borrower or, in the absence thereof, the requirements of generally accepted accounting principles applicable to businesses similar to that of the Borrower.

"Advance" or "Advances" shall mean advances by CFC to Borrower pursuant to the terms and conditions of this Agreement.

"Amortization Basis Date" shall mean the first calendar day of the month following the end of the Billing Cycle in which the Advance occurs, provided, however, that if the Advance is made on the first day of a Billing Cycle, and such day is a Business Day, then the Amortization Basis Date shall be the date of the Advance.

"Billing Cycle" shall mean any 3-month period ending on, and including, a Payment Date.

"Business Day" shall mean any day that both CFC and the depository it utilizes for funds transfers hereunder are open for business.

"CFC Commitment" shall have the meaning as defined in Schedule 1.

"CFC Fixed Rate" shall mean such fixed rate as is then available for loans similarly classified pursuant to CFC's policies and procedures then in effect.

"CFC Fixed Rate Term" shall mean the specific period of time that a CFC Fixed Rate is in effect.

"CFC Variable Rate" shall mean the rate established by CFC for variable interest rate long-term loans similarly classified pursuant to the long-term loan programs established by CFC from time to time.

"Conversion Request" shall mean a request from any duly authorized official of the Borrower, in form and substance satisfactory to CFC, that requests an interest rate conversion.

"Debt Service Coverage Ratio ("DSC")" shall mean the ratio determined as follows: for any calendar year add (a) Operating Margins, (b) Non-Operating Margins--Interest, (c) Interest Expense, (d) Depreciation and Amortization Expense for such year, and (e) cash received in respect of generation and transmission and other capital credits, and divide the sum so obtained by the sum of all payments of Principal and Interest Expense required to be made during such calendar year; provided, however, that in the event that any Long-Term Debt has been refinanced during such year the payments of Principal and Interest Expense required to be made during such year on account of such Long-Term Debt shall be based (in lieu of actual payments required to be made on such refinanced Long-Term Debt) upon the larger of (i) an annualization of the payments required to be made with respect to the refinancing debt during the portion of such year such refinancing debt is outstanding, or (ii) the payment of Principal and Interest Expense required to be made during the following year on account of such refinancing debt.

"Depreciation and Amortization Expense" shall mean an amount constituting the depreciation and amortization of the Borrower as computed for purposes of Form 7.

"Distributions" shall have the meaning defined in Section 5.H.

"Equities and Margins" shall mean Borrower's equities and margins as computed pursuant to generally accepted accounting principles.

"Equity" shall mean the aggregate of Borrower's Equities and Margins as computed pursuant to generally accepted accounting principles.

"Form 12" shall mean the RUS Form 12, and any successor form(s), as the same may be amended from time to time.

"Interest Expense" shall mean an amount constituting the interest expense with respect to Total Long-Term Debt of the Borrower as computed for purposes of Form 12. In computing Interest Expense, there shall be added, to the extent not otherwise included, an amount equal to 33-1/3% of the excess of Restricted Rentals paid by the Borrower over two percent (2%) of the Borrower's Equity.

"LCTC" shall mean the Loan Capital Term Certificate as described in Section 5.D. hereto.

"Long-Term Debt" shall mean any amount included in Total Long-Term Debt pursuant to generally accepted accounting principles.

"Maturity Date" shall have the meaning as defined in the Note.

"Non-Operating Margins--Interest" shall mean the amount of non-operating margins-interest of Borrower as computed for purposes of Form 12.

"Note" or **"Notes"** shall mean one or more promissory notes, dated as of even date herewith, executed and delivered by the Borrower pursuant to this Agreement to evidence an indebtedness in the aggregate principal amount up to the amount of the CFC Commitment.

"Operating Margins" shall mean the net amount of operating revenue and patronage capital less the total cost of electric service of the Borrower as computed for purposes of Form 12.

"Payment Date" shall mean the last day of each of the months referred to in Schedule 1.

"Payment Notice" shall mean a notice furnished by CFC to Borrower that indicates the amount of each payment of principal and interest and the total amount of each payment.

"Principal" shall mean the amount of principal billed on account of Total Long-Term Debt of the Borrower as computed for purposes of Form 12.

"Restricted Rentals" shall mean all rentals required to be paid under finance leases and charged to income, exclusive of any amounts paid under any such lease (whether or not designated therein as rental or additional rental) for maintenance or repairs, insurance, taxes, assessments, water rates or similar charges. For the purpose of this definition the term "finance lease" shall mean any lease having a rental term (including the term for which such lease may be renewed or extended at the option of the lessee) in excess of three (3) years and covering property having an initial cost in excess of \$250,000 other than automobiles, trucks, trailers, other vehicles (including without limitation aircraft and ships), office, garage and warehouse space and office equipment (including without limitation computers).

"RUS" shall mean the Rural Utilities Service of the United States of America, Department of Agriculture and any successor governmental agency.

"Termination Date" shall mean a date four (4) years after the date hereof.

"Total Assets" shall mean an amount constituting the total assets of the Borrower as computed for purposes of Form 12.

"Total Long-Term Debt" shall mean an amount constituting the long-term debt of the Borrower as computed for purposes of Form 12.

"Total Utility Plant" shall mean the amount constituting the total utility plant of the Borrower computed in accordance with generally accepted accounting principles.

ARTICLE II

REPRESENTATIONS AND WARRANTIES

Section 2. The Borrower represents and warrants to CFC as of the date of this Agreement that:

A. Good Standing. The Borrower is a corporation duly organized, validly existing and in good standing under the laws of the state of its incorporation, is duly qualified to do business and is in good standing in those states in which it is required to be qualified to conduct its business and has the corporate power to enter into and perform this Agreement and to borrow hereunder. The Borrower is a member in good standing of CFC.

B. Authority. Borrower has the corporate power and authority to enter into this Agreement and the Note; to make the borrowing hereunder; to execute and deliver all documents and instruments required hereunder and to incur and perform the obligations provided for herein and in the Note, all of which have been duly authorized by all necessary and proper corporate and other action; and no consent or approval of any person, including, without limitation, stockholders and members of Borrower and any public authority or regulatory body, which has not been obtained is required as a condition to the validity or enforceability hereof or thereof.

C. No Conflicting Agreements. The execution, delivery of and performance by Borrower of this Agreement and the Note, and the transactions contemplated hereby or thereby, will not: (i) violate any provision of law, any order, rule or regulation of any court or other agency of government, any award of any arbitrator, the articles of incorporation or by-laws of Borrower, or any indenture, contract, agreement, mortgage, deed of trust or other instrument to which Borrower is a party or by which it or any of its property is bound; or (ii) be in conflict with, result in a breach of or constitute (with due notice and/or lapse of time) a default under, any such award, indenture, contract, agreement, mortgage, deed of trust or other instrument. The Borrower is not in default of any of its obligations to RUS.

D. Taxes. Borrower has paid or caused to be paid all federal, state and local taxes to the extent that such taxes have become due. Borrower has filed or caused to be filed all federal, state and local tax returns which are required to be filed by Borrower.

E. Licenses and Permits. Borrower has duly obtained and now holds all licenses, permits, certifications, approvals and the like necessary to own and operate its property and business that are required by federal, state and local laws of the jurisdictions in which Borrower conducts its business and each remains valid and in full force and effect.

F. Litigation. There are no outstanding judgments, suits, claims, actions or proceedings pending or to the knowledge of the Borrower threatened against or affecting the Borrower or its properties which, if adversely determined, would have a material adverse effect upon the financial condition or the business of the Borrower. The Borrower is not, to its knowledge, in default or violation with respect to any judgment, order, writ, injunction, decree, rule or regulation of any court, governmental agency or other instrumentality which would have a material adverse effect on the Borrower.

G. Financial Statements. The balance sheet of the Borrower as at the date identified in Schedule 1 hereto, and the statement of operations of the Borrower for the period ending on

said date, heretofore furnished to CFC, are complete and correct. Said balance sheet fairly presents the financial condition of the Borrower as at said date and said statement of operations fairly reflects its operations for the period ending on said date. The Borrower has no contingent obligations or unusual forward or long-term commitments except as specifically stated in said balance sheet or herein. There has been no material adverse change in the financial condition or operations of the Borrower from that set forth in said financial statements except changes disclosed in writing to CFC prior to the date hereof. The Borrower has heretofore furnished to CFC true and complete copies of its financial and statistical reports to the RUS on RUS Form 12 (or any successor form) for the month of December for each of the three (3) most recent calendar years, and a copy of its most recent such report on RUS Form 12 (or any successor form) and the facts stated therein are true and correct as of the date hereof.

H. Required Approvals. The Borrower has obtained all licenses, consents and approvals of all governmental agencies or authorities that are required to enable the Borrower to enter into this Agreement or any Note, or to perform any of its obligations provided for in such documents, including without limitation (and if applicable), any state public utilities commission and any state public service commission.

ARTICLE III

LOAN

Section 3.1. Advances. CFC agrees to make, and the Borrower agrees to request, on the terms and conditions of this Agreement, Advances from time to time at the office of CFC in Herndon, Virginia, or at such other place as may be mutually agreed upon, in an aggregate principal amount not to exceed the CFC Commitment.

On the Termination Date, CFC may stop advancing funds and limit the CFC Commitment to the amount advanced prior to such date. The obligation of the Borrower to repay the Advances shall be evidenced by the Note. The Borrower shall give CFC written notice of the date on which each Advance is to be made.

Section 3.2. Interest Rate and Payment. The Note shall be payable and bear interest as follows:

A. Payments and Amortization. For each Advance, Borrower shall promptly pay interest in the amount shown in the Payment Notice on each Payment Date until the first Payment Date of the Billing Cycle in which the Amortization Basis Date occurs.

On such Payment Date, and on each Payment Date thereafter, Borrower shall promptly pay interest and principal in the amounts shown in the Payment Notice. If not sooner paid, any amount due on account of the unpaid principal, interest accrued thereon and fees, if any, shall be due and payable on the Maturity Date. On or after the Amortization Basis Date, and thereafter at least quarterly, CFC will furnish to the Borrower a Payment Notice. Such Payment Notice shall be sent to the Borrower at least ten (10) days before the next ensuing Payment Date.

Principal will be amortized in accordance with the method stated in Schedule 1 hereto.

No provision of this Agreement or the Note shall require the payment, or permit the collection, of interest in excess of the highest rate permitted by applicable law.

B. Application of Payments. Each payment shall be applied first to any charges other than interest or principal then due on the Note, second to interest accrued on the principal amount to the due date of such payment on the Note (or, at the election of the holder of the Note, to the date of such payment if the same is not paid on its due date), and the balance to the reduction of principal against the Note according to an amortization schedule provided to Borrower from CFC.

C. Election of Interest Rate. Prior to each Advance on the Note, the Borrower must select in writing one of the following interest rates: (i) a CFC Fixed Rate; or (ii) the CFC Variable Rate.

Interest on Advances bearing interest at a CFC Fixed Rate shall be computed for the actual number of days elapsed on the basis of a year of 365 days, until the first day of the Billing Cycle in which the Amortization Basis Date occurs; Interest shall then be computed on the basis of a 30-day month and 360-day year. If the Advance bears interest at the CFC Variable Rate, interest shall be computed for the actual number of days elapsed on the basis of a year of 365 days.

(i) Fixed Rate. If the Borrower elects a CFC Fixed Rate for an Advance, then such rate shall be in effect for the CFC Fixed Rate Term selected by Borrower. CFC shall provide the Borrower with at least sixty (60) days prior written notice of the date on which the CFC Fixed Rate is due to reprice. Pursuant to CFC's policies of general application for such repricing, the Borrower may choose any of the interest rate options then available for similarly classified borrowers repricing from a CFC Fixed Rate. If Borrower does not select an interest rate in writing when a CFC Fixed Rate is subject to repricing, then the Advance subject to such CFC Fixed Rate shall reprice to, and shall bear interest at, the CFC Variable Rate. CFC agrees that its long-term loan policies will include a fixed interest rate option until the Maturity Date, provided, however, that the Borrower may not select a CFC Fixed Rate with a CFC Fixed Rate Term that extends beyond the Maturity Date.

(ii) CFC Variable Rate. If the Borrower elects a CFC Variable Rate, such CFC Variable Rate shall apply until the Maturity Date unless the Borrower elects to convert to a CFC Fixed Rate pursuant to the terms hereof.

Section 3.3. Conversion of Interest Rates.

A. CFC Variable Rate to a CFC Fixed Rate. The Borrower may, at its option, at any time request to convert from the CFC Variable Rate to a CFC Fixed Rate by submitting to CFC a Conversion Request. The rate shall be equal to the rate of interest offered by CFC in effect on the date of the Conversion Request. The effective date of the new interest rate shall be a date determined by CFC pursuant to its policies of general application following receipt of the Conversion Request.

B. CFC Fixed Rate to CFC Variable Rate. The Borrower may, at its option, at any time convert a CFC Fixed Rate to the CFC Variable Rate if the Borrower: (i) submits a Conversion Request requesting that the CFC Variable Rate apply to any outstanding loan balance on the Advance pursuant thereto; and (ii) pays to CFC promptly upon receipt of an invoice any applicable conversion fee calculated pursuant to CFC's long-term loan policies as established from time to time for similarly classified long-term loans. The effective date of the CFC Variable Rate shall be a

date determined by CFC pursuant to its policies of general application following receipt of the Conversion Request.

C. A CFC Fixed Rate to Another CFC Fixed Rate. The Borrower may, at its option, at any time convert from a CFC Fixed Rate to another CFC Fixed Rate if the Borrower (i) submits a Conversion Request requesting that a CFC Fixed Rate apply to any outstanding loan balance on the Advance; and (ii) pays to CFC promptly upon receipt of an invoice any applicable conversion fee calculated pursuant to CFC's long-term loan policies as established from time to time for similarly classified long-term loans. The effective date of the new interest rate shall be a date determined by CFC pursuant to its policies of general application following receipt of the Conversion Request.

Section 3.4. Prepayment. The Borrower may at any time, on not less than thirty (30) days written notice to CFC, prepay the Note, in whole or in part, together with the interest accrued to the date of prepayment and any prepayment premium that CFC may from time to time prescribe pursuant to its policies of general application.

ARTICLE IV

CONDITIONS OF LENDING

Section 4. The obligation of CFC to make any Advance hereunder is subject to satisfaction of the following conditions:

A. Legal Matters. All legal matters incident to the consummation of the transactions hereby contemplated shall be satisfactory to counsel for CFC and, as to all matters of local law, to such local counsel as counsel for CFC may retain.

B. Documents. CFC shall have been furnished with executed originals, satisfactory to CFC, of this Agreement and the Note and certified copies, satisfactory to CFC, of all such corporate documents and proceedings of the Borrower authorizing the transactions hereby contemplated as CFC shall require. CFC shall have received an opinion of counsel for the Borrower addressing such legal matters as CFC shall reasonably require.

C. Government Approvals. The Borrower shall have furnished to CFC true and correct copies of all certificates, authorizations and consents, including without limitation the consents referred to in Section 2.1. hereof, necessary for the execution, delivery or performance by the Borrower of this Agreement and the Note.

D. Representations and Warranties. The representations and warranties contained in Article II shall be true on the date of the making of each Advance hereunder with the same effect as though such representations and warranties had been made on such date; no Event of Default specified in Article VI and no event which, with the lapse of time or the notice and lapse of time specified in Article VI would become such an Event of Default, shall have occurred and be continuing or will have occurred after giving effect to the Advance on the books of the Borrower; there shall have occurred no material adverse change in the business or condition, financial or otherwise, of the Borrower; and nothing shall have occurred which in the opinion of CFC and RUS materially and adversely affects the Borrower's ability to meet its obligations hereunder.

E. Requisitions. The Borrower will requisition all Advances by submitting its requisition to CFC in form and substance satisfactory to CFC. Requisitions shall be made only for the purpose(s) set forth herein. The Borrower agrees to apply the proceeds of the Advances in accordance with its loan application with such modifications as may be mutually agreed.

F. Special Conditions. The Borrower shall have complied with any special conditions listed in Schedule 1 hereto.

ARTICLE V

COVENANTS

Section 5. After the date hereof and until payment in full of all Notes and performance of all obligations of the Borrower hereunder:

A. Membership. The Borrower agrees that it will remain a member in good standing of CFC.

B. Financial Ratios; Design of Rates. The Borrower, subject to events in the judgment of CFC to be beyond the control of the Borrower, shall so operate and manage its business as to achieve an annual DSC of not less than 1.0, said DSC being determined by averaging the two (2) highest annual ratios during the most recent three (3) calendar years. The Borrower shall design its rates so that such ratio will be achieved. The Borrower shall not decrease its rates for electric service if it has failed to achieve a DSC of 1.0 for the calendar year prior to such reduction subject only to an order from a regulatory body properly exercising jurisdiction over the Borrower.

C. Annual Certificates. Within one hundred-twenty (120) days after the close of each calendar year, commencing with the year in which the initial Advance hereunder shall have been made, Borrower will deliver to CFC a written statement, in form and substance satisfactory to CFC, signed by its General Manager, stating that during such year, and that to the best of said person's knowledge, the Borrower has fulfilled all of its obligations under this Agreement and the Note throughout such year or, if there has been a default in the fulfillment of any such obligations, specifying each such default known to said person and the nature and status thereof. Borrower shall also deliver to CFC such other information as CFC may reasonably request from time to time

D. Loan Capital Term Certificate Purchase. Borrower will purchase an LCTC, if required, in an amount calculated pursuant to CFC's policies of general application. The purchase price of the LCTC, if any, shall be calculated pursuant to CFC's policies as established from time to time for loans similarly classified. Such purchase shall be paid for in equal quarterly installments pursuant to CFC's policies. CFC agrees to deliver the LCTC within ninety (90) days following the date on which the LCTC has been paid for in full.

E. Financial Books; Financial Reports; Right of Inspection. Borrower will at all times keep, and safely preserve, proper books, records and accounts in which full and true entries will be made of all of the dealings, business and affairs of the Borrower, in accordance with generally accepted accounting principles. When requested by CFC, the Borrower will prepare and furnish CFC from time to time, periodic financial and statistical reports on its condition and operations. All of such reports shall be in such form and include such information as may be specified by CFC, including without limitation an analysis of Borrower's revenues, expenses and

consumer accounts. Within one hundred twenty (120) days of the end of each calendar year during the term hereof, Borrower shall furnish to CFC a full and complete report of its financial condition and statement of its operations as of the end of such calendar year, in form and substance satisfactory to CFC. In addition, within one hundred twenty (120) days of the end of each Borrower's fiscal years during the term hereof, Borrower shall furnish to CFC a full and complete report of its financial condition and statement of its operations as of the end of such fiscal year, audited and certified by independent certified public accountants nationally recognized or otherwise satisfactory to CFC and accompanied by a report of such audit in form and substance satisfactory to CFC. CFC, through its representatives, shall at all times during reasonable business hours and upon prior notice have access to, and the right to inspect and make copies of, any or all books, records and accounts, and any or all invoices, contracts, leases, payrolls, canceled checks, statements and other documents and papers of every kind belonging to or in the possession of the Borrower or in anyway pertaining to its property or business.

F. Limitations on Mergers and Sale, Lease or Transfer of Capital Assets; Application of Proceeds. The Borrower may consolidate with, merge, or sell all or substantially all of its business or assets, to another entity or person provided such action is either approved, as is evidenced by the prior written consent of CFC, or the purchaser, successor or resulting corporation is or becomes a member in good standing of CFC and assumes the due and punctual payment of the Notes and the due and punctual performance of the covenants contained in this Agreement. Notwithstanding anything in this Agreement to the contrary, in the event that Borrower does not obtain the written consent of CFC prior to consolidating with, merging or selling all or substantially all of its business assets to another entity or person, then CFC may stop advancing funds and limit the CFC Commitment to the amount advanced as of the effective date of such consolidation, merger or sale. If no Event of Default (and no event which with notice or lapse of time and notice would become an Event of Default) shall have occurred and be continuing, Borrower may, without the prior written consent of CFC, sell, lease or transfer any capital asset in exchange for fair market value consideration paid to the Borrower if the value of such capital asset is less than five percent (5%) of Total Utility Plant and the aggregate value of capital assets sold, leased or transferred in any 12-month period is less than ten percent (10%) of Total Utility Plant. If the Borrower does sell, lease or transfer any capital assets, then the proceeds thereof (less ordinary and reasonable expenses incident to such transaction) shall immediately (i) be applied as a prepayment of the Notes, to such installments as may be designated by CFC at the time of any such prepayment; (ii) in the case of dispositions of equipment, material or scrap, applied to the purchase of other property useful in the Borrower's business, although not necessarily of the same kind as the property disposed of, or (iii) applied to the acquisition or construction of other property or in reimbursement of the costs of such property.

G. Limitation on Dividends, Patronage Refunds and Other Distributions.

(i) The Borrower may make Distributions in any calendar year if, after giving effect to the Distribution, the total Equity of the Borrower will be at least twenty percent (20%) of its Total Assets.

(ii) If, after giving effect to the Distribution, the total Equity of the Borrower will be less than twenty percent (20%) of its Total Assets, then the Borrower may nevertheless make Distributions of up to thirty percent (30%) of its total margins for the preceding calendar year.

(iii) Notwithstanding anything to the contrary in subparagraphs (i) and (ii) above, the Borrower shall not make any Distribution without the prior written consent of CFC if (a) a payment

default or other Event of Default under this Agreement has occurred and is continuing, or (b) such Distribution would be in excess of the Distributions permitted by subparagraphs (i) or (ii), above.

(iv) For purposes of this paragraph H., the term "Distribution" means any dividend, patronage refund, patronage capital retirement or cash distribution to its members, stockholders or consumers (including but not limited to any general cancellation or abatement of charges for electric energy or services furnished by the Borrower). The term "Distribution" shall *not* include (a) a distribution by the Borrower to the estate of a deceased patron, (b) repayment by the Borrower of a membership fee upon termination of a membership, or (c) any rebate to a patron resulting from a cost abatement received by the Borrower, such as a reduction of wholesale power cost previously incurred.

H. Limitations on Loans, Investments and Other Obligations.

(i) The Borrower shall not, without first obtaining the written approval of CFC: (a) purchase or make any commitment to purchase any stock, bonds, notes, debentures, or other securities or obligations of or beneficial interests in, (b) make any other investment in, (c) make any loan to, or (d) guarantee, assume, or otherwise become liable for any obligation of any corporation, association, partnership, joint venture, trust, government or any agency or department thereof, or any other entity of any kind if, after giving effect to such purchase, investment, loan, guarantee or commitment, the aggregate amount thereof would exceed three percent (3%) of Total Utility Plant.

(ii) The following shall not be included in the limitation of purchases, investments, loans and guarantees in (i) and (ii) above: (a) bonds, notes, debentures, stock, or other securities or obligations issued by or guaranteed by the United States government or any agency or instrumentality thereof; (b) bonds, notes, debentures, stock, commercial paper, subordinated capital certificates, or any other security or obligation of institutions whose senior unsecured debt obligations are rated by at least two nationally recognized rating organizations in either of their two highest categories; (c) investments incidental to loans made by CFC; and (d) any deposit that is fully insured by the Federal Government.

(iii) In no event may the Borrower take any action pursuant to subsection (i) when there is: (a) unpaid any due installment of principal and/or interest on the Note; or (b) Borrower has failed to meet the financial ratio tests in Section 5.B. herein.

I. Organizational Change. Borrower agrees that it shall not, directly or indirectly, change its type of organization, jurisdiction of organization or other legal structure, except (i) with the prior written consent of CFC, or (ii) as permitted by Section 5, Paragraph G. hereof, in which case Borrower shall provide written notice to CFC within 30 days of any such permitted change.

J. Special Covenants. Borrower agrees to comply with any special covenants identified in Schedule 1.

ARTICLE VI

EVENTS OF DEFAULT

Section 6. The following shall be "Events of Default" under this Agreement:

A. Payment. Borrower shall fail to pay any amount due under the terms of the Note or this Agreement within five (5) Business Days of when the same shall be due and payable, whether by acceleration or otherwise;

B. Representations and Warranties. Any representation or warranty made by the Borrower herein or in any certificate or financial statement furnished to CFC hereunder shall prove to be false or misleading in any material respect;

C. Other Covenants. Default by the Borrower in the observance or performance of any other covenant or agreement contained in this Loan Agreement or in a Note, which shall continue for thirty (30) calendar days after written notice thereof shall have been given to the Borrower by CFC;

D. Corporate Existence. The Borrower shall forfeit or otherwise be deprived of its corporate charter, franchises, permits, easements, consents or licenses required to carry on any material portion of its business;

E. Other Obligations. Default by the Borrower in the payment of any obligation, whether direct or contingent, for borrowed money or in the performance or observance of the terms of any instrument pursuant to which such obligation was created or securing such obligation;

F. Bankruptcy. The Borrower shall file a petition in bankruptcy or be adjudicated bankrupt or insolvent, or shall make an assignment for the benefit of its creditors, or shall consent to the appointment of a receiver of itself or of its property, or shall institute proceedings for its reorganization, or proceedings instituted by others for its reorganization shall not be dismissed within sixty (60) days after the institution thereof;

G. Dissolution or Liquidation. Other than as provided in subsection F. above, the dissolution or liquidation of the Borrower, or failure by the Borrower promptly to forestall or remove any execution, garnishment or attachment of such consequence as will impair its ability to continue its business or fulfill its obligations and such execution, garnishment or attachment shall not be vacated within sixty (60) days. The term "dissolution or liquidation of the Borrower", as used in this subsection, shall not be construed to include the cessation of the corporate existence of the Borrower resulting either from a merger or consolidation of the Borrower into or with another corporation following a transfer of all or substantially all its assets as an entirety, under the conditions set forth in Section 5.G. permitting such actions; or

H. Final Judgment. A final judgment in excess of \$100,000.00 shall be entered against the Borrower and shall remain unsatisfied or without a stay for a period of sixty (60) days.

ARTICLE VII

REMEDIES

Section 7. If any of the Events of Default listed in Section 6 hereof shall occur after the date of this Agreement and shall not have been remedied within the grace periods specified therein, then CFC may pursue all rights and remedies available to CFC that are contemplated by this Agreement or any Note in the manner, upon the conditions, and with the effect provided in this Agreement or any Note, including, but not limited to, terminating Borrower's ability to make additional Advances hereunder, a suit for specific performance, injunctive relief, damages or to declare all unpaid principal outstanding on the Note, all accrued and unpaid interest thereon, and all other obligations to be immediately due and payable and the same shall thereupon become immediately due and payable without presentment, demand, protest or notice of any kind, all of which are hereby expressly waived. Nothing herein shall limit the right of CFC to pursue all rights and legal and equitable remedies available to a creditor following the occurrence of an Event of Default listed in Section 6 hereof. Each right, power and remedy of CFC shall be cumulative and concurrent, and recourse to one or more rights or remedies shall not constitute a waiver of any other right, power or remedy.

ARTICLE VIII

MISCELLANEOUS

Section 8.1. Notices. All notices, requests and other communications provided for herein including, without limitation, any modifications of, or waivers, requests or consents under, this Agreement shall be given or made in writing (including, without limitation, by telecopy) and delivered or telecopied to the intended recipient at the "Address for Notices" specified below; or, as to any party, at such other address as shall be designated by such party in a notice to each other party. Except as otherwise provided in this Agreement, all such communications shall be deemed to have been duly given when personally delivered or, in the case of a telecopied or mailed notice, upon receipt, in each case given or addressed as provided for herein. The Addresses for Notices of the respective parties are as follows:

CFC:

National Rural Utilities Cooperative Finance Corporation
2201 Cooperative Way
Herndon, Virginia 20171-3025
Attention: Senior Vice President - Member Services
Fax: (703) 709-6776

The Borrower:

The address set forth
in Schedule 1

Section 8.2. Expenses. The Borrower will pay all costs and expenses of CFC, including reasonable fees of counsel, incurred in connection with the enforcement of this Agreement, the

Note and the other instruments provided for herein or with the preparation for such enforcement if CFC has reasonable grounds to believe that such enforcement may be necessary.

Section 8.3. Late Payments. If payment of any amount due hereunder is not received at CFC's office in Herndon, Virginia, or such other location as CFC may designate to the Borrower within five (5) Business Days after the due date thereof or such other time period as CFC may prescribe from time to time in its policies of general application in connection with any late payment charge (such unpaid amount being herein called the "delinquent amount", and the period beginning after such due date until payment of the delinquent amount being herein called the "late-payment period"), the Borrower will pay to CFC, in addition to all other amounts due under the terms of the Note and this Agreement, any late-payment charge as may be fixed by CFC from time to time on the delinquent amount for the late-payment period.

Section 8.4. Filing Fees. To the extent permitted by law, the Borrower agrees to pay all expenses of CFC (including the fees and expenses of its counsel) in connection with all documentary stamps, recordation and transfer taxes and other costs and taxes incident to recordation of any document or instrument in connection herewith. Borrower agrees to save harmless and indemnify CFC from and against any liability resulting from the failure to pay any required documentary stamps, recordation and transfer taxes or any other expenses incurred by CFC in connection with this Agreement. The provisions of this subsection shall survive the execution and delivery of this Agreement and the payment of all other amounts due hereunder or due on the Note.

Section 8.5. No Waiver. No failure on the part of CFC to exercise, and no delay in exercising, any right hereunder shall operate as a waiver thereof nor shall any single or partial exercise by CFC of any right hereunder preclude any other or further exercise thereof or the exercise of any other right.

SECTION 8.6. GOVERNING LAW; SUBMISSION TO JURISDICTION; WAIVER OF JURY TRIAL.

A. THE PERFORMANCE AND CONSTRUCTION OF THIS AGREEMENT AND THE NOTE SHALL BE GOVERNED BY, AND CONSTRUED IN ACCORDANCE WITH, THE LAWS OF THE COMMONWEALTH OF VIRGINIA.

B. BORROWER HEREBY SUBMITS TO THE NONEXCLUSIVE JURISDICTION OF THE UNITED STATES COURTS LOCATED IN VIRGINIA AND OF ANY STATE COURT SO LOCATED FOR PURPOSES OF ALL LEGAL PROCEEDINGS ARISING OUT OF OR RELATING TO THIS AGREEMENT OR THE TRANSACTIONS CONTEMPLATED HEREBY. BORROWER IRREVOCABLY WAIVES, TO THE FULLEST EXTENT PERMITTED BY APPLICABLE LAW, ANY OBJECTION THAT IT MAY NOW OR HEREAFTER HAVE TO THE ESTABLISHING OF THE VENUE OF ANY SUCH PROCEEDING BROUGHT IN SUCH A COURT AND ANY CLAIM THAT ANY SUCH PROCEEDING HAS BEEN BROUGHT IN AN INCONVENIENT FORUM.

C. EACH OF THE BORROWER AND CFC HEREBY IRREVOCABLY WAIVES, TO THE FULLEST EXTENT PERMITTED BY APPLICABLE LAW, ANY AND ALL RIGHT TO TRIAL BY JURY IN ANY LEGAL PROCEEDING ARISING OUT OF OR RELATING TO THIS AGREEMENT OR THE TRANSACTIONS CONTEMPLATED HEREBY.

Section 8.7. Holiday Payments. If any payment to be made by the Borrower hereunder shall become due on a day which is not a Business Day, such payment shall be made on the next succeeding Business Day and such extension of time shall be included in computing any interest in respect of such payment.

Section 8.8. Rescission Fee. The Borrower may elect not to borrow all or any portion of the CFC Commitment, in which event CFC shall release the Borrower from its obligations hereunder provided the Borrower complies with such terms and conditions as CFC may impose for such release including, without limitation, payment of any rescission fee that CFC may from time to time prescribe pursuant to its policies of general application.

Section 8.9. Modifications. No modification or waiver of any provision of this Agreement or the Note and no consent to any departure by Borrower therefrom, shall in any event be effective unless the same shall be in writing by the party granting such modification, waiver or consent.

Section 8.10. Merger and Integration. This Agreement (including the Recitals and all exhibits and schedules hereto) and matters incorporated by reference herein contain the entire agreement of the parties hereto with respect to the matters covered and the transactions contemplated hereby.

Section 8.11. Headings. The headings and sub-headings contained in the titling of this Agreement are intended to be used for convenience only and do not constitute part of this Agreement.

Section 8.12. Severability. If any term, provision or condition, or any part thereof, of this Agreement or the Note shall for any reason be found or held invalid or unenforceable by any governmental agency or court of competent jurisdiction, such invalidity or unenforceability shall not affect the remainder of such term, provision or condition nor any other term, provision or condition, and this Agreement and the Note shall survive and be construed as if such invalid or unenforceable term, provision or condition had not been contained therein.

Section 8.13. Right of Setoff. Upon the occurrence and during the continuance of any Event of Default, CFC is hereby authorized at any time and from time to time, without prior notice to the Borrower, to exercise rights of setoff or recoupment and apply any and all amounts held, or hereafter held, by CFC or owed to the Borrower or for the credit or account of the Borrower against any and all of the obligations of the Borrower now or hereafter existing hereunder or under the Note. CFC agrees to notify the Borrower promptly after any such setoff or recoupment and the application thereof, provided that the failure to give such notice shall not affect the validity of such setoff, recoupment or application. The rights of CFC under this section are in addition to any other rights and remedies (including other rights of setoff or recoupment) which CFC may have. Borrower waives all rights of setoff, deduction, recoupment or counterclaim.

Section 8.14. Schedule 1. Schedule 1 attached hereto is an integral part of this Agreement.

IN WITNESS WHEREOF, the parties hereto have caused this Agreement to be duly executed as of the day and year first above written.

ARIZONA ELECTRIC POWER COOPERATIVE,
INC.

(SEAL)

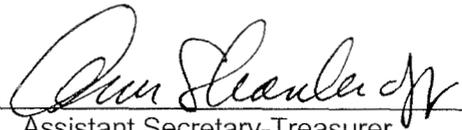
By: 
DONALD W. KIMBALL

Title: EXECUTIVE VICE PRESIDENT &
CHIEF EXECUTIVE OFFICER

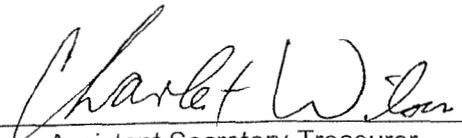
Attest: 
Secretary

NATIONAL RURAL UTILITIES
COOPERATIVE FINANCE CORPORATION

(SEAL)

By: 
Assistant Secretary-Treasurer

ANN SHANKROFF

Attest: 
Assistant Secretary-Treasurer

CHARLES WILSON

SCHEDULE 1

1. The purposes of these loans are as follows:
 - (a) Loan No. 9032: to fund the costs of closing and reclaiming the Borrower's Combustion Waste Disposal Facility at Apache State
 - (b) Loan No. 9034: to provide interim financing for the construction of a Low Volume Waste Water Pond until the earlier of (i) the date on which permanent financing from RUS becomes available or (ii) December 31, 2007.
2. The total aggregate "CFC Commitment" is \$7,349,724.00.
3. The "Payment Date" months are March, June, September and December.
4. The date of the Borrower's balance sheet referred to in Section 2.H. is December 31, 2004.
5. The Borrower selects the following number of Notes (each Note representing a separate loan with CFC), the amount of each Note, and the Maturity Date for each Note:

Loan Designation	Note Amount	Note Maturity Date
AZ028-A-9032	\$4,287,339.00	December 31, 2014
AZ028-A-9034	\$3,062,385.00	December 31, 2007

6. The method of amortization of Advances referred to in Section 3.2.A. shall be:

Loan No. 9032: level principal payments or level debt service payments at Borrower's election

Loan No. 9034: interest only
7. The special condition referred to in Section 4.F. is as follows: None
8. The special covenants referred to in Section 5.J. are:
 - (a) Borrower hereby agrees not to create, incur, assume, become or be liable in any manner in respect of, any indebtedness except: (i) Borrower's obligations under the Notes and this Agreement, and (ii) accounts payable to trade creditors for goods or services incurred in the ordinary course of business, as presently conducted, and paid within the specified time, unless contested in good faith and by appropriate proceedings.

(b) Borrower hereby agrees to comply in every material respect with the terms, conditions, and covenants of that certain Consolidated Mortgage and Security Agreement, dated

as of June 14, 1989, by and among Borrower, CFC and RUS, as it has been or may be restated, consolidated, supplemented or amended from time to time (the "Mortgage"), and that Borrower's failure to so comply shall be deemed to be an Event of Default under this Agreement.

(c) In addition to satisfying the requirements set forth in Section 5.E. of this Agreement, Borrower hereby agrees, upon the request of CFC, to prepare and furnish CFC from time to time, periodic financial and statistical reports on its condition and operations, including balance sheets, as well as 24-month cash flow forecasts annually. All of such reports shall be in form and substance satisfactory to CFC.

(d) Borrower hereby agrees that within ninety (90) days of any rate case adjudication, Borrower shall provide CFC with an updated, long-term financial forecast incorporating the implementation of the approved rate increases and compliance with the Mortgage covenants.

(e) Borrower hereby agrees that within one hundred eighty (180) days of the date of this Agreement, Borrower shall provide to CFC a written certification that an application for a loan to refinance CFC Loan No. 9034 has been submitted to RUS for approval.

9. The address for notices to the Borrower referred to in Section 8.1 is 1000 South Highway 80, Benson, Arizona 85602, Attention: General Manager, Fax: (520) 586-5343.



LOAN AGREEMENT
(\$612,661.00 Equity Loan)

LOAN AGREEMENT ("Agreement"), dated as of August 15, 2005 by and between ARIZONA ELECTRIC POWER COOPERATIVE, INC. ("Borrower"), a cooperative corporation organized under the laws of Arizona (the "State") and NATIONAL RURAL UTILITIES COOPERATIVE FINANCE CORPORATION ("CFC"), a cooperative association incorporated under the laws of the District of Columbia.

RECITALS

WHEREAS, the Borrower has applied to CFC for a non-revolving, term loan for purposes of purchasing LCTCs required in connection with a loan from CFC to Borrower bearing CFC loan designation AZ028-A-9032 (referred to herein as the "Corresponding Loan", and the loan agreement governing the terms thereof as the "Corresponding Loan Agreement");

WHEREAS, CFC is willing to make such a loan to the Borrower on the terms and conditions stated herein;

NOW, THEREFORE, for and in consideration of the premises and the mutual covenants hereinafter contained, the parties hereto agree and bind themselves as follows:

ARTICLE I

DEFINITIONS

For purposes of this Agreement, the following capitalized terms shall have the following meanings (such definitions to be equally applicable to the singular and the plural form thereof):

"Accounting Requirements" shall mean any system of accounts prescribed by a federal regulatory authority having jurisdiction over the Borrower or, in the absence thereof, the requirements of generally accepted accounting principles applicable to businesses similar to that of the Borrower.

"Advance" or "Advances" shall mean one or more advances of funds by CFC to Borrower under the Note and pursuant to the terms and conditions of this Agreement.

"Average DSC Ratio" shall mean the average of the Borrower's two highest annual DSC Ratios during the most recent three calendar years.

"Business Day" shall mean any day that both CFC and the depository it utilizes for funds transfers hereunder are open for business.

"CFC Commitment" shall have the meaning as defined in Schedule 1 hereto.

"Debt Service Coverage ("DSC") Ratio" shall mean the ratio determined as follows: for any calendar year add (i) Operating Margins, (ii) Non-Operating Margins--Interest, (iii) Interest Expense, (iv) Depreciation and Amortization Expense for such year, and (v) cash received in respect of generation and transmission and other capital credits, and divide the sum so obtained

by the sum of all payments of principal and interest during such calendar year; *provided, however*, that in the event that any long-term debt has been refinanced during such year the payments of Principal and Interest Expense required to be made during such year on account of such long-term debt shall be based (in lieu of actual payments required to be made on such refinanced long-term debt) upon the larger of (i) an annualization of the payments required to be made with respect to the refinancing debt during the portion of such year such refinancing debt is outstanding or (ii) the payment of Principal and Interest Expense required to be made during the following year on account of such refinancing debt.

"Depreciation and Amortization Expense" shall mean an amount constituting the depreciation and amortization of the Borrower as computed in accordance with the Accounting Requirements.

"Distribution" shall mean any dividend, patronage refund, patronage capital retirement or cash distribution to Borrower's members or consumers (including but not limited to any general cancellation or abatement of charges for electric energy or services furnished by the Borrower).

"Equity" shall mean the aggregate of Borrower's equities and margins as computed in accordance with the Accounting Requirements.

"Interest Expense" shall mean an amount constituting the interest expense with respect to Total Long-Term Debt of the Borrower as computed in accordance with the Accounting Requirements. In computing Interest Expense, there shall be added, to the extent not otherwise included, an amount equal to 33-1/3% of the excess of Restricted Rentals paid by the Borrower over 2% of the Borrower's Equity.

"LCTC" shall have the meaning given to such term in the Corresponding Loan Agreement.

"Maturity Date" shall mean the maturity date of the Corresponding Loan.

"Non-Operating Margins--Interest" shall mean the amount of non-operating margins-interest of Borrower as computed in accordance with the Accounting Requirements.

"Note" shall mean the promissory note executed by Borrower pursuant to this Agreement, and shall include any substituted, amended and/or replacement notes issued pursuant hereto.

"Patronage Capital and Operating Margins" shall mean the net amount of operating revenue and patronage capital less the total cost of electric service of the Borrower as computed in accordance with the Accounting Requirements.

"Principal" shall mean the amount of principal billed on account of Total Long-Term Debt of Borrower as computed in accordance with the Accounting Requirements.

"Restricted Rentals" shall mean all rentals required to be paid under finance leases and charged to income, exclusive of any amount paid under any such lease (whether or note designated herein as rental or additional rental) for maintenance or repairs, insurance, taxes, assessments, water rates or similar charges. For the purpose of this definition the term "finance lease" shall mean any lease having a rental term (including the term for which such lease may be renewed or extended at the option of the lessee) in excess of three (3) years and covering

property having an initial cost in excess of \$250,000 other than automobiles, trucks, trailers, other vehicles (including without limitation aircraft and ships), office, garage and warehouse space and office equipment (including without limitation computers).

"Total Assets" shall mean an amount constituting the total assets of the Borrower as computed in accordance with the Accounting Requirements.

"Total Long-Term Debt" shall mean an amount constituting the long-term debt of the Borrower as computed in accordance with the Accounting Requirements.

"Total Utility Plant" shall mean the amount constituting the total utility plant of the Borrower as computed in accordance with the Accounting Requirements.

ARTICLE II

REPRESENTATIONS AND WARRANTIES

Section 2.1. The Borrower represents and warrants that:

A. Good Standing. The Borrower is a corporation duly incorporated, validly existing and in good standing under the laws of the state of its incorporation, is duly qualified in those states in which it is required to be qualified to conduct its business and has corporate power to enter into and perform this Agreement and to borrow hereunder. The Borrower is a member in good standing of CFC.

B. Authority. The execution, delivery and performance by the Borrower of this Agreement and the Note and the performance of the transactions contemplated thereby have been duly authorized by all necessary corporate action and will not violate any provision of law or of the Articles of Incorporation or bylaws of the Borrower or result in a breach of, or constitute a default under, any agreement, indenture or other instrument to which the Borrower is a party or by which it may be bound.

C. Litigation. There are no suits or proceedings pending or, to the knowledge of the Borrower, threatened against or affecting the Borrower or its properties which, if adversely determined, would have a material adverse effect upon the financial condition or the business of the Borrower. The Borrower is not, to its knowledge, in default with respect to any judgment, order, rule or regulation of any court, governmental agency or other instrumentality which would have a material adverse effect on the Borrower.

D. Financial Statements. The balance sheet of the Borrower as at the date identified in Schedule 1 hereto, and the statement of operations of the Borrower for the period ending on said date, heretofore furnished to CFC, are complete and correct. Said balance sheet fairly presents the financial condition of the Borrower as at said date and said statement of operations fairly reflects its operations for the period ending on said date. The Borrower has no contingent obligation or unusual forward or long-term commitments except as specifically stated in said balance sheet or herein. There has been no material adverse change in the financial condition or operations of the Borrower from that set forth in said financial statements except changes disclosed in writing to CFC prior to the date hereof.

E. **Survival.** All representations and warranties made by the Borrower herein or made in any certificate delivered pursuant hereto shall survive the making of the Advances and the execution and delivery to CFC of the Note.

ARTICLE III

LOAN

SECTION 3. Advances shall be made on the following terms:

A. Advances.

(1) Advances shall be made automatically and concurrently with advances made under the Corresponding Loan, so that the amount of each Advance shall equal 14.29% of each advance made under the Corresponding Loan. Borrower hereby irrevocably authorizes and instructs CFC to make Advances automatically as described in this Section 2.A.

(2) Advances in an aggregate principal amount at any one time outstanding shall not exceed the CFC Commitment.

(3) The obligation of the Borrower to repay the Advances shall be evidenced by the Note.

(4) Advances shall not amortize.

(5) Advances shall be used solely for the purchase of LCTCs required in connection with the Corresponding Loan.

(6) Advances which are repaid may not be re-borrowed.

B. Interest Rate. The interest rate on the Advances shall be a fixed rate of interest determined on the date of the first Advance. Said rate shall be equal to the CFC stated fixed rate of interest rate charged on loans having a one-year term.

C. Maturity. All amounts outstanding under this Agreement and the Note, if not sooner paid, shall be finally due and payable on the Maturity Date.

D. Possession of LCTC. CFC shall retain possession of the LCTC until the Note is paid in full.

E. Prepayments. Advances may be prepaid hereunder only if the Corresponding Loan has been paid in full. No prepayment premium shall be required.

ARTICLE IV

CONDITIONS OF LENDING

Section 4. The obligation of CFC to make any Advance hereunder is subject to satisfaction of the following conditions:

A. Legal Matters. All legal matters incident to the consummation of the transactions hereby contemplated shall be satisfactory to counsel for CFC and, as to all matters of local law, to such local counsel as counsel for CFC may retain.

B. Documents. CFC shall have been furnished with executed copies, satisfactory to CFC, of this Agreement, and the Note and certified copies, satisfactory to CFC, of all such corporate documents and proceedings of the Borrower authorizing the transactions hereby contemplated as CFC shall require. CFC shall have received an opinion of counsel for the Borrower addressing such legal matters as CFC shall reasonably require.

C. Representations and Warranties. The representations and warranties contained in Article II shall (except as affected by the transactions contemplated by this Agreement) be true on the date of the making of each Advance hereunder with the same effect as though such representations and warranties had been made on such date; no Event of Default specified in Article VI and no event which, with the lapse of time or the notice and lapse of time specified in Article VI would become such an Event of Default, shall have occurred and be continuing or will have occurred after giving effect to the Advance on the books of the Borrower; there shall have occurred no material adverse change in the business or condition, financial or otherwise, of the Borrower; and nothing shall have occurred which in the opinion of CFC materially and adversely affects the Borrower's ability to meet its obligations hereunder.

ARTICLE V

COVENANTS

Section 5. After the date hereof and until payment in full of the Note and performance of all obligations of the Borrower hereunder:

A. Membership. Borrower agrees that it will remain a member in good standing of CFC.

B. Financial Ratios; Design of Rates.

(1) The Borrower shall achieve an Average DSC Ratio of not less than 1.0.

(2) The Borrower shall, subject to applicable law, design its rates and operate and manage its business so that the Average DSC Ratio will be achieved.

(3) The Borrower shall not decrease its rates for electric service if it has failed to achieve a DSC Ratio of 1.0 for the calendar year prior to such reduction, subject only to an order from a regulatory body properly exercising jurisdiction over the Borrower.

C. Annual Certificate. In the event that the Maturity Date is extended, then within one hundred-twenty (120) days after the close of each calendar year, Borrower will deliver to CFC a written statement signed by its General Manager, stating that during such year, and that to the best of said person's knowledge, the Borrower has fulfilled all of its obligations under this Agreement and the Note throughout such year or, if there has been a default in the fulfillment of any such obligations, specifying each such default known to said person and the nature and status thereof.

E. Notice of Change in Place of Business. Borrower will notify CFC promptly in writing of any change in location of its principal place of business or the office where its records concerning accounts and contract rights are kept.

F. Financial Books; Financial Reports; Right of Inspection. Borrower will at all times keep, and safely preserve, proper books, records and accounts in which full and true entries will be made of all of the dealings, business and affairs of the Borrower, in accordance with generally accepted accounting principles. When requested by CFC, the Borrower will prepare and furnish CFC from time to time, periodic financial and statistical reports on its condition and operations. All of such reports shall be in such form and include such information as may be specified by CFC, including without limitation an analysis of Borrower's revenues, expenses and consumer accounts. Within one hundred twenty (120) days of the end of each calendar year during the term hereof, Borrower shall furnish to CFC a full and complete report of its financial condition and statement of its operations as of the end of such calendar year, in form and substance satisfactory to CFC. In addition, within one hundred twenty (120) days of the end of each Borrower's fiscal years during the term hereof, Borrower shall furnish to CFC a full and complete report of its financial condition and statement of its operations as of the end of such fiscal year, audited and certified by independent certified public accountants nationally recognized or otherwise satisfactory to CFC and accompanied by a report of such audit in form and substance satisfactory to CFC. CFC, through its representatives, shall at all times during reasonable business hours and upon prior notice have access to, and the right to inspect and make copies of, any or all books, records and accounts, and any or all invoices, contracts, leases, payrolls, canceled checks, statements and other documents and papers of every kind belonging to or in the possession of the Borrower or in anyway pertaining to its property or business.

G. Limitations on Mergers. The Borrower may consolidate with, merge, or sell all or substantially all of its business or assets, to another entity or person provided such action is approved by prior written consent of CFC.

H. Limitation on Dividends, Patronage Refunds and Other Distributions.

(1) The Borrower may make Distributions in any calendar year if, after giving effect to the Distribution, the total Equity of the Borrower will be at least twenty percent (20%) of its Total Assets.

(2) If, after giving effect to the Distribution, the total Equity of the Borrower will be less than twenty percent (20%) of its Total Assets, then the Borrower may nevertheless make Distributions of up to twenty percent (20%) of its total margins for the preceding calendar year.

(3) Notwithstanding anything to the contrary in subparagraphs (1) and (2) above, the Borrower shall not make any Distribution without the prior written consent of CFC if (i) a payment default or other Event of Default under this Agreement has occurred and is continuing, or (ii) after giving effect to the Distribution, the Borrower's total current and accrued assets would be less than its total current and accrued liabilities, or (iii) such Distribution would be in excess of the Distributions permitted by subparagraphs (1) or (2), above.

(4) For purposes of this paragraph H., the term "Distribution" means any dividend, patronage refund, patronage capital retirement or cash distribution to its members, stockholders or consumers (including but not limited to any general cancellation or abatement of charges for electric energy or services furnished by the Borrower). The term "Distribution" shall *not* include (a)

a distribution by the Borrower to the estate of a deceased patron, (b) repayment by the Borrower of a membership fee upon termination of a membership, or (c) any rebate to a patron resulting from a cost abatement received by the Borrower, such as a reduction of wholesale power cost previously incurred.

I. Limitations on Loans, Investments and Other Obligations.

(1) The Borrower shall not, without first obtaining the written approval of CFC: (i) purchase or make any commitment to purchase any stock, bonds, notes, debentures, or other securities or obligations of or beneficial interests in, (ii) make any other investment in, (iii) make any loan to, or (iv) guarantee, assume, or otherwise become liable for any obligation of any corporation, association, partnership, joint venture, trust, government or any agency or department thereof, or any other entity of any kind if the aggregate amount of all such purchases, investments, loans and guarantees exceeds three percent (3%) of Total Utility Plant.

(2) The following shall not be included in the limitation of purchases, investments, loans and guarantees in (a) above: (i) bonds, notes, debentures, stock, or other securities or obligations issued by or guaranteed by the United States government or any agency or instrumentality thereof; (ii) bonds, notes, debentures, stock, commercial paper, subordinated capital certificates, or any other security or obligation of institutions whose senior unsecured debt obligations are rated by at least two nationally recognized rating organizations in either of its two highest categories; (iii) investments incidental to loans made by CFC; and (iv) any deposit that is fully insured by the Federal Government.

(3) In no event may the Borrower take any action pursuant to subsection (a) when there is: (i) unpaid any due installment of principal and/or interest on the Note; or (ii) Borrower has failed to meet the financial ratio tests in Section 5.B. herein.

J. Change of Name. Borrower will notify CFC promptly in writing of any change to the name of Borrower.

K. Limitation on Additional Indebtedness. Except for trade payables incurred in the ordinary course of business, Borrower shall not, without CFC's prior written consent, incur any additional debt other than RUS Loans or loans from CFC or CFC's affiliates.

L. Use of Proceeds. Advances shall be used solely to satisfy the Borrower's obligation to purchase the LCTCs required as a condition of making advances to Borrower under the terms of the Corresponding Loan.

ARTICLE VI

EVENTS OF DEFAULT

Section 6. The following shall be Events of Default under this Agreement:

A. Representations and Warranties. Any representation or warranty made by the Borrower herein in any certificate or financial statement furnished to CFC hereunder which shall prove to be false or misleading in any material respect.

B. Payment. Default shall be made in the payment of or on account of interest on or principal of (or premium, if any, associated with) the Note when and as the same shall be due and payable, whether by acceleration or otherwise;

C. DSC Covenant. Borrower shall fail to meet the financial ratio covenant specified in Section 5.B.(1), or shall decrease its rates in breach of the covenant specified in Section 5.B.(3) hereof;

D. Other Covenants. Default by the Borrower in the observance or performance of any other covenant or agreement contained in this Agreement or in the Note, which shall remain unremedied for thirty (30) calendar days after written notice thereof shall have been given to the Borrower by CFC;

E. Corporate Existence. Borrower shall forfeit or otherwise be deprived of its corporate charter, franchises, permits, easements, consents or licenses required to carry on any material portion of its business;

F. Other Obligations. Default by the Borrower in the payment of any obligation, whether direct or contingent, for borrowed money or in the performance or observance of the terms of any instrument pursuant to which such obligation was created or securing such obligation;

G. Involuntary Bankruptcy. An involuntary case or other proceeding shall be commenced against the Borrower seeking liquidation, reorganization or other relief with respect to it or its debts under bankruptcy, insolvency or other similar law now or hereafter in effect or seeking the appointment of a trustee, receiver, liquidator, custodian or other similar official of it or any substantial part of its property and such involuntary case or other proceeding shall continue without dismissal or stay for a period of thirty (30) consecutive days; or an order for relief shall be entered against Borrower under the federal bankruptcy laws or applicable state law as now or hereafter in effect;

H. Insolvency. Borrower shall commence a voluntary case or other proceeding seeking liquidation, reorganization or other relief with respect to itself or its debts under any bankruptcy, insolvency or other similar law now or hereafter in effect or seeking the appointment of a trustee, receiver, liquidator, custodian or other similar official of it or any substantial part of its property, or shall consent to any such relief or to the appointment of or taking possession by any such official in an involuntary case or proceeding commenced against it, or shall make a general assignment for the benefit of creditors, or shall admit in writing its inability to, or be generally unable to, pay its debts as they become due, or shall take any action to authorize any of the foregoing;

I. Dissolution or Liquidation. Other than as provided in subsections G. or H. above, the dissolution or liquidation of the Borrower, or failure by the Borrower promptly to forestall or remove any execution, garnishment or attachment of such consequence as will impair its ability to continue its business or fulfill its obligations and such execution, garnishment or attachment shall not be vacated within thirty (30) days. The term "dissolution or liquidation of the Borrower", as used in this subsection, shall not be construed to include the cessation of the corporate existence of the Borrower resulting either from a merger or consolidation of the Borrower into or with another corporation following a transfer of all or substantially all its assets as an entirety,

under the conditions permitting such actions, including required approval from CFC under the terms hereof.

J. Final Judgment. A final judgment in excess of \$100,000 shall be entered against the Borrower and shall remain unsatisfied or without a stay for a period of thirty (30) days.

ARTICLE VII

REMEDIES

Section 7.01 General Remedies. In addition to the actions described in Section 7.02 and 7.03 hereof, if any Event of Default shall occur after the date of this Agreement and shall not have been remedied within the applicable time periods prescribed herein, then CFC may declare all amounts due on account of this Agreement or the Note to be immediately due and payable and may pursue all other rights and remedies available to CFC that are contemplated by this Agreement in the manner, upon the conditions, and with the effect provided in this Agreement, including but not limited to, a suit for specific performance, injunctive relief or damages. Nothing herein shall limit the right of CFC to pursue all rights and remedies available to a creditor following the occurrence of an Event of Default. Each right, power and remedy of CFC shall be cumulative and concurrent, and recourse to one or more rights or remedies shall not constitute a waiver of any other right, power or remedy.

Section 7.02 No Further Advances. If any of the Events of Default shall occur after the date of this Agreement and shall not have been remedied, then CFC, without incurring any liability on its part to the Borrower or to any other person, may refuse to make any Advances hereunder.

Section 7.03. Right of Setoff. Upon the occurrence and during the continuance of any Event of Default, CFC is hereby authorized at any time and from time to time, without prior notice to the Borrower, to exercise rights of setoff or recoupment and apply any and all amounts held, or hereby held, by CFC or owed to the Borrower or for the credit on account of the Borrower against any and all of the obligations of the Borrower now or hereafter existing hereunder or under the Note. CFC agrees to notify the Borrower promptly after any such setoff or recoupment and the application thereof; provided that the failure to give such notice shall not affect the validity of such setoff, recoupment or application. The rights of CFC under this Section 7.03. are in addition to any other rights and remedies (including other rights of setoff or recoupment) which CFC may have. Borrower waives all rights of setoff, deduction, recoupment and counterclaim.

ARTICLE VIII

MISCELLANEOUS

Section 8.1. Notices. All notices, requests and other communications provided for herein including, without limitation, any modifications of, or waivers, requests or consents under, this Agreement shall be given or made in writing (including, without limitation, by telecopy) and delivered to the intended recipient at the "Address for Notices" specified below; or, as to any party, at such other address as shall be designated by such party in a notice to each other party. Except as otherwise provided in this Agreement, all such communications shall be deemed to have been duly given when personally delivered or, in the case of a telecopied or mailed notice, upon receipt, in each case given or addressed as provided for herein. The Addresses for Notices of the respective parties are as follows:

CFC LOANAG
AZ028-A-9033 (SMALLK)
88688-1

National Rural Utilities Cooperative Finance Corporation
2201 Cooperative Way
Herndon, Virginia 20171
Fax: (703) 709-6776

Attention: Senior Vice President, Member Services

The Borrower:
The address set forth in Schedule 1 hereto

Section 8.2. Expenses. The Borrower will pay all costs and expenses of CFC, including reasonable fees of counsel, incurred in connection with the enforcement of this Agreement and the Note and the other instruments provided for herein or with the preparation for such enforcement if CFC has reasonable grounds to believe that such enforcement may be necessary.

Section 8.3. No Waiver. No failure on the part of CFC to exercise, and no delay in exercising, any right under this Agreement or the Note shall operate as a waiver thereof nor shall any single or partial exercise by CFC of any right under this Agreement or the Note preclude any other or further exercise thereof or the exercise of any other right. No waiver of any provision of this Agreement or the Note and no consent to any departure by Borrower therefrom shall in any event be effective unless the same shall be in writing by the party granting such waiver or consent.

SECTION 8.4. GOVERNING LAW; SUBMISSION TO JURISDICTION; WAIVER OF JURY TRIAL.

(a) THE PERFORMANCE AND CONSTRUCTION OF THIS AGREEMENT AND THE NOTE SHALL BE GOVERNED BY, AND CONSTRUED IN ACCORDANCE WITH, THE LAWS OF THE COMMONWEALTH OF VIRGINIA.

(b) BORROWER HEREBY SUBMIT(S) TO THE NONEXCLUSIVE JURISDICTION OF THE UNITED STATES COURTS LOCATED IN VIRGINIA AND OF ANY STATE COURT SO LOCATED FOR PURPOSES OF ALL LEGAL PROCEEDINGS ARISING OUT OF OR RELATING TO THIS AGREEMENT OR THE TRANSACTIONS CONTEMPLATED HEREBY. BORROWER IRREVOCABLY WAIVES, TO THE FULLEST EXTENT PERMITTED BY APPLICABLE LAW, ANY OBJECTION THAT IT MAY NOW OR HEREAFTER HAVE TO THE ESTABLISHING OF THE VENUE OF ANY SUCH PROCEEDING BROUGHT IN SUCH A COURT AND ANY CLAIM THAT ANY SUCH PROCEEDING HAS BEEN BROUGHT IN AN INCONVENIENT FORUM.

(c) EACH OF THE BORROWER AND CFC HEREBY IRREVOCABLY WAIVES, TO THE FULLEST EXTENT PERMITTED BY APPLICABLE LAW, ANY AND ALL RIGHT TO TRIAL BY JURY IN ANY LEGAL PROCEEDING ARISING OUT OF OR RELATING TO THIS AGREEMENT OR THE TRANSACTIONS CONTEMPLATED HEREBY.

Section 8.5. Amendments. No amendment of any provision of this Agreement or the Note shall in any event be effective unless the same shall be in writing and signed by both CFC and the Borrower.

Section 8.6. Merger and Integration. This Agreement and the attached exhibits and matters incorporated by reference contain the entire agreement of the parties hereto with respect to the matters covered and the transactions contemplated hereby.

Section 8.7. Headings. The headings and sub-headings contained in the titling of this Agreement are intended to be used for convenience only and do not constitute part of this Agreement.

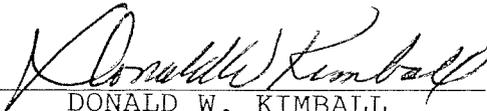
Section 8.8. Severability. If any term, provision or condition, or any part thereof, of this Agreement or the Note shall for any reason be found or held invalid or unenforceable by any governmental agency or court of competent jurisdiction, such invalidity or unenforceability shall not affect the remainder of such term, provision or condition nor any other term, provision or condition, and this Agreement and the Note shall survive and be construed as if such invalid or unenforceable term, provision or condition had not been contained therein.

Section 8.9. Schedule 1. Schedule 1 attached hereto is an integral part of this Agreement and is incorporated by reference herein.

IN WITNESS WHEREOF, the parties hereto have caused this Agreement to be duly executed as of the day and year first above written.

ARIZONA ELECTRIC POWER COOPERATIVE, INC.

(SEAL)

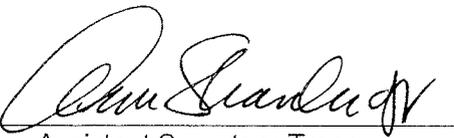
By: 
DONALD W. KIMBALL

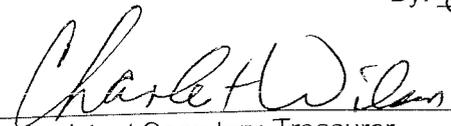
Title: EXECUTIVE VICE PRESIDENT &
CHIEF EXECUTIVE OFFICER

Attest: 
Secretary

**NATIONAL RURAL UTILITIES
COOPERATIVE FINANCE CORPORATION**

(SEAL)

By: 
Assistant Secretary-Treasurer

Attest: 
Assistant Secretary-Treasurer

ANN SHANKROFF

CHARLES WILSON

SCHEDULE 1

1. The CFC Commitment is Six Hundred Twelve Thousand Six Hundred Sixty-One Dollars (\$612,661.00), representing the equity purchase requirement with respect to Corresponding Loan No. AZ028-A-9032.
2. The Borrower's chief place of business and its address for notices is 1000 South Highway 80, Benson, Arizona 85602, Attention: General Manager, Fax: (520) 586-5343.
3. The date of the Borrower's balance sheet referred to in Section 2.1.D. is December 31, 2004.



LOAN AGREEMENT
(\$437,615.00 Equity Loan)

LOAN AGREEMENT ("Agreement"), dated as of August 15, _____, 2005 by and between ARIZONA ELECTRIC POWER COOPERATIVE, INC. ("Borrower"), a cooperative corporation organized under the laws of Arizona (the "State") and NATIONAL RURAL UTILITIES COOPERATIVE FINANCE CORPORATION ("CFC"), a cooperative association incorporated under the laws of the District of Columbia.

RECITALS

WHEREAS, the Borrower has applied to CFC for a non-revolving, term loan for purposes of purchasing LCTCs required in connection with a loan from CFC to Borrower bearing CFC loan designation AZ028-A-9034 (referred to herein as the "Corresponding Loan", and the loan agreement governing the terms thereof as the "Corresponding Loan Agreement");

WHEREAS, CFC is willing to make such a loan to the Borrower on the terms and conditions stated herein;

NOW, THEREFORE, for and in consideration of the premises and the mutual covenants hereinafter contained, the parties hereto agree and bind themselves as follows:

ARTICLE I

DEFINITIONS

For purposes of this Agreement, the following capitalized terms shall have the following meanings (such definitions to be equally applicable to the singular and the plural form thereof):

"Accounting Requirements" shall mean any system of accounts prescribed by a federal regulatory authority having jurisdiction over the Borrower or, in the absence thereof, the requirements of generally accepted accounting principles applicable to businesses similar to that of the Borrower.

"Advance" or "Advances" shall mean one or more advances of funds by CFC to Borrower under the Note and pursuant to the terms and conditions of this Agreement.

"Average DSC Ratio" shall mean the average of the Borrower's two highest annual DSC Ratios during the most recent three calendar years.

"Business Day" shall mean any day that both CFC and the depository it utilizes for funds transfers hereunder are open for business.

"CFC Commitment" shall have the meaning as defined in Schedule 1 hereto.

"Debt Service Coverage ("DSC") Ratio" shall mean the ratio determined as follows: for any calendar year add (i) Operating Margins, (ii) Non-Operating Margins--Interest, (iii) Interest Expense, (iv) Depreciation and Amortization Expense for such year, and (v) cash received in respect of generation and transmission and other capital credits, and divide the sum so obtained

by the sum of all payments of principal and interest during such calendar year; *provided, however*, that in the event that any long-term debt has been refinanced during such year the payments of Principal and Interest Expense required to be made during such year on account of such long-term debt shall be based (in lieu of actual payments required to be made on such refinanced long-term debt) upon the larger of (i) an annualization of the payments required to be made with respect to the refinancing debt during the portion of such year such refinancing debt is outstanding or (ii) the payment of Principal and Interest Expense required to be made during the following year on account of such refinancing debt.

"Depreciation and Amortization Expense" shall mean an amount constituting the depreciation and amortization of the Borrower as computed in accordance with the Accounting Requirements.

"Distribution" shall mean any dividend, patronage refund, patronage capital retirement or cash distribution to Borrower's members or consumers (including but not limited to any general cancellation or abatement of charges for electric energy or services furnished by the Borrower).

"Equity" shall mean the aggregate of Borrower's equities and margins as computed in accordance with the Accounting Requirements.

"Interest Expense" shall mean an amount constituting the interest expense with respect to Total Long-Term Debt of the Borrower as computed in accordance with the Accounting Requirements. In computing Interest Expense, there shall be added, to the extent not otherwise included, an amount equal to 33-1/3% of the excess of Restricted Rentals paid by the Borrower over 2% of the Borrower's Equity.

"LCTC" shall have the meaning given to such term in the Corresponding Loan Agreement.

"Maturity Date" shall mean the maturity date of the Corresponding Loan.

"Non-Operating Margins--Interest" shall mean the amount of non-operating margins-interest of Borrower as computed in accordance with the Accounting Requirements.

"Note" shall mean the promissory note executed by Borrower pursuant to this Agreement, and shall include any substituted, amended and/or replacement notes issued pursuant hereto.

"Patronage Capital and Operating Margins" shall mean the net amount of operating revenue and patronage capital less the total cost of electric service of the Borrower as computed in accordance with the Accounting Requirements.

"Principal" shall mean the amount of principal billed on account of Total Long-Term Debt of Borrower as computed in accordance with the Accounting Requirements.

"Restricted Rentals" shall mean all rentals required to be paid under finance leases and charged to income, exclusive of any amount paid under any such lease (whether or note designated herein as rental or additional rental) for maintenance or repairs, insurance, taxes, assessments, water rates or similar charges. For the purpose of this definition the term "finance lease" shall mean any lease having a rental term (including the term for which such lease may be renewed or extended at the option of the lessee) in excess of three (3) years and covering

property having an initial cost in excess of \$250,000 other than automobiles, trucks, trailers, other vehicles (including without limitation aircraft and ships), office, garage and warehouse space and office equipment (including without limitation computers).

"Total Assets" shall mean an amount constituting the total assets of the Borrower as computed in accordance with the Accounting Requirements.

"Total Long-Term Debt" shall mean an amount constituting the long-term debt of the Borrower as computed in accordance with the Accounting Requirements.

"Total Utility Plant" shall mean the amount constituting the total utility plant of the Borrower as computed in accordance with the Accounting Requirements.

ARTICLE II

REPRESENTATIONS AND WARRANTIES

Section 2.1. The Borrower represents and warrants that:

A. Good Standing. The Borrower is a corporation duly incorporated, validly existing and in good standing under the laws of the state of its incorporation, is duly qualified in those states in which it is required to be qualified to conduct its business and has corporate power to enter into and perform this Agreement and to borrow hereunder. The Borrower is a member in good standing of CFC.

B. Authority. The execution, delivery and performance by the Borrower of this Agreement and the Note and the performance of the transactions contemplated thereby have been duly authorized by all necessary corporate action and will not violate any provision of law or of the Articles of Incorporation or bylaws of the Borrower or result in a breach of, or constitute a default under, any agreement, indenture or other instrument to which the Borrower is a party or by which it may be bound.

C. Litigation. There are no suits or proceedings pending or, to the knowledge of the Borrower, threatened against or affecting the Borrower or its properties which, if adversely determined, would have a material adverse effect upon the financial condition or the business of the Borrower. The Borrower is not, to its knowledge, in default with respect to any judgment, order, rule or regulation of any court, governmental agency or other instrumentality which would have a material adverse effect on the Borrower.

D. Financial Statements. The balance sheet of the Borrower as at the date identified in Schedule 1 hereto, and the statement of operations of the Borrower for the period ending on said date, heretofore furnished to CFC, are complete and correct. Said balance sheet fairly presents the financial condition of the Borrower as at said date and said statement of operations fairly reflects its operations for the period ending on said date. The Borrower has no contingent obligation or unusual forward or long-term commitments except as specifically stated in said balance sheet or herein. There has been no material adverse change in the financial condition or operations of the Borrower from that set forth in said financial statements except changes disclosed in writing to CFC prior to the date hereof.

E. Survival. All representations and warranties made by the Borrower herein or made in any certificate delivered pursuant hereto shall survive the making of the Advances and the execution and delivery to CFC of the Note.

ARTICLE III

LOAN

SECTION 3. Advances shall be made on the following terms:

A. Advances.

(1) Advances shall be made automatically and concurrently with advances made under the Corresponding Loan, so that the amount of each Advance shall equal 14.29% of each advance made under the Corresponding Loan. Borrower hereby irrevocably authorizes and instructs CFC to make Advances automatically as described in this Section 2.A.

(2) Advances in an aggregate principal amount at any one time outstanding shall not exceed the CFC Commitment.

(3) The obligation of the Borrower to repay the Advances shall be evidenced by the Note.

(4) Advances shall not amortize.

(5) Advances shall be used solely for the purchase of LCTCs required in connection with the Corresponding Loan.

(6) Advances which are repaid may not be re-borrowed.

B. Interest Rate. The interest rate on the Advances shall be a fixed rate of interest determined on the date of the first Advance. Said rate shall be equal to the CFC stated fixed rate of interest rate charged on loans having a one-year term.

C. Maturity. All amounts outstanding under this Agreement and the Note, if not sooner paid, shall be finally due and payable on the Maturity Date.

D. Possession of LCTC. CFC shall retain possession of the LCTC until the Note is paid in full.

E. Prepayments. Advances may be prepaid hereunder only if the Corresponding Loan has been paid in full. No prepayment premium shall be required.

ARTICLE IV

CONDITIONS OF LENDING

Section 4. The obligation of CFC to make any Advance hereunder is subject to satisfaction of the following conditions:

A. Legal Matters. All legal matters incident to the consummation of the transactions hereby contemplated shall be satisfactory to counsel for CFC and, as to all matters of local law, to such local counsel as counsel for CFC may retain.

B. Documents. CFC shall have been furnished with executed copies, satisfactory to CFC, of this Agreement, and the Note and certified copies, satisfactory to CFC, of all such corporate documents and proceedings of the Borrower authorizing the transactions hereby contemplated as CFC shall require. CFC shall have received an opinion of counsel for the Borrower addressing such legal matters as CFC shall reasonably require.

C. Representations and Warranties. The representations and warranties contained in Article II shall (except as affected by the transactions contemplated by this Agreement) be true on the date of the making of each Advance hereunder with the same effect as though such representations and warranties had been made on such date; no Event of Default specified in Article VI and no event which, with the lapse of time or the notice and lapse of time specified in Article VI would become such an Event of Default, shall have occurred and be continuing or will have occurred after giving effect to the Advance on the books of the Borrower; there shall have occurred no material adverse change in the business or condition, financial or otherwise, of the Borrower; and nothing shall have occurred which in the opinion of CFC materially and adversely affects the Borrower's ability to meet its obligations hereunder.

ARTICLE V

COVENANTS

Section 5. After the date hereof and until payment in full of the Note and performance of all obligations of the Borrower hereunder:

A. Membership. Borrower agrees that it will remain a member in good standing of CFC.

B. Financial Ratios; Design of Rates.

(1) The Borrower shall achieve an Average DSC Ratio of not less than 1.0.

(2) The Borrower shall, subject to applicable law, design its rates and operate and manage its business so that the Average DSC Ratio will be achieved.

(3) The Borrower shall not decrease its rates for electric service if it has failed to achieve a DSC Ratio of 1.0 for the calendar year prior to such reduction, subject only to an order from a regulatory body properly exercising jurisdiction over the Borrower.

C. Annual Certificate. In the event that the Maturity Date is extended, then within one hundred-twenty (120) days after the close of each calendar year, Borrower will deliver to CFC a written statement signed by its General Manager, stating that during such year, and that to the best of said person's knowledge, the Borrower has fulfilled all of its obligations under this Agreement and the Note throughout such year or, if there has been a default in the fulfillment of any such obligations, specifying each such default known to said person and the nature and status thereof.

E. Notice of Change in Place of Business. Borrower will notify CFC promptly in writing of any change in location of its principal place of business or the office where its records concerning accounts and contract rights are kept.

F. Financial Books; Financial Reports; Right of Inspection. Borrower will at all times keep, and safely preserve, proper books, records and accounts in which full and true entries will be made of all of the dealings, business and affairs of the Borrower, in accordance with generally accepted accounting principles. When requested by CFC, the Borrower will prepare and furnish CFC from time to time, periodic financial and statistical reports on its condition and operations. All of such reports shall be in such form and include such information as may be specified by CFC, including without limitation an analysis of Borrower's revenues, expenses and consumer accounts. Within one hundred twenty (120) days of the end of each calendar year during the term hereof, Borrower shall furnish to CFC a full and complete report of its financial condition and statement of its operations as of the end of such calendar year, in form and substance satisfactory to CFC. In addition, within one hundred twenty (120) days of the end of each Borrower's fiscal years during the term hereof, Borrower shall furnish to CFC a full and complete report of its financial condition and statement of its operations as of the end of such fiscal year, audited and certified by independent certified public accountants nationally recognized or otherwise satisfactory to CFC and accompanied by a report of such audit in form and substance satisfactory to CFC. CFC, through its representatives, shall at all times during reasonable business hours and upon prior notice have access to, and the right to inspect and make copies of, any or all books, records and accounts, and any or all invoices, contracts, leases, payrolls, canceled checks, statements and other documents and papers of every kind belonging to or in the possession of the Borrower or in anyway pertaining to its property or business.

G. Limitations on Mergers. The Borrower may consolidate with, merge, or sell all or substantially all of its business or assets, to another entity or person provided such action is approved by prior written consent of CFC.

H. Limitation on Dividends, Patronage Refunds and Other Distributions.

(1) The Borrower may make Distributions in any calendar year if, after giving effect to the Distribution, the total Equity of the Borrower will be at least twenty percent (20%) of its Total Assets.

(2) If, after giving effect to the Distribution, the total Equity of the Borrower will be less than twenty percent (20%) of its Total Assets, then the Borrower may nevertheless make Distributions of up to twenty percent (20%) of its total margins for the preceding calendar year.

(3) Notwithstanding anything to the contrary in subparagraphs (1) and (2) above, the Borrower shall not make any Distribution without the prior written consent of CFC if (i) a payment default or other Event of Default under this Agreement has occurred and is continuing, or (ii) after giving effect to the Distribution, the Borrower's total current and accrued assets would be less than its total current and accrued liabilities, or (iii) such Distribution would be in excess of the Distributions permitted by subparagraphs (1) or (2), above.

(4) For purposes of this paragraph H., the term "Distribution" means any dividend, patronage refund, patronage capital retirement or cash distribution to its members, stockholders or consumers (including but not limited to any general cancellation or abatement of charges for electric energy or services furnished by the Borrower). The term "Distribution" shall *not* include (a)

a distribution by the Borrower to the estate of a deceased patron, (b) repayment by the Borrower of a membership fee upon termination of a membership, or (c) any rebate to a patron resulting from a cost abatement received by the Borrower, such as a reduction of wholesale power cost previously incurred.

I. Limitations on Loans, Investments and Other Obligations.

(1) The Borrower shall not, without first obtaining the written approval of CFC: (i) purchase or make any commitment to purchase any stock, bonds, notes, debentures, or other securities or obligations of or beneficial interests in, (ii) make any other investment in, (iii) make any loan to, or (iv) guarantee, assume, or otherwise become liable for any obligation of any corporation, association, partnership, joint venture, trust, government or any agency or department thereof, or any other entity of any kind if the aggregate amount of all such purchases, investments, loans and guarantees exceeds three percent (3%) of Total Utility Plant.

(2) The following shall not be included in the limitation of purchases, investments, loans and guarantees in (a) above: (i) bonds, notes, debentures, stock, or other securities or obligations issued by or guaranteed by the United States government or any agency or instrumentality thereof; (ii) bonds, notes, debentures, stock, commercial paper, subordinated capital certificates, or any other security or obligation of institutions whose senior unsecured debt obligations are rated by at least two nationally recognized rating organizations in either of its two highest categories; (iii) investments incidental to loans made by CFC; and (iv) any deposit that is fully insured by the Federal Government.

(3) In no event may the Borrower take any action pursuant to subsection (a) when there is: (i) unpaid any due installment of principal and/or interest on the Note; or (ii) Borrower has failed to meet the financial ratio tests in Section 5.B. herein.

J. Change of Name. Borrower will notify CFC promptly in writing of any change to the name of Borrower.

K. Limitation on Additional Indebtedness. Except for trade payables incurred in the ordinary course of business, Borrower shall not, without CFC's prior written consent, incur any additional debt other than RUS Loans or loans from CFC or CFC's affiliates.

L. Use of Proceeds. Advances shall be used solely to satisfy the Borrower's obligation to purchase the LCTCs required as a condition of making advances to Borrower under the terms of the Corresponding Loan.

ARTICLE VI

EVENTS OF DEFAULT

Section 6. The following shall be Events of Default under this Agreement:

A. Representations and Warranties. Any representation or warranty made by the Borrower herein in any certificate or financial statement furnished to CFC hereunder which shall prove to be false or misleading in any material respect.

B. Payment. Default shall be made in the payment of or on account of interest on or principal of (or premium, if any, associated with) the Note when and as the same shall be due and payable, whether by acceleration or otherwise;

C. DSC Covenant. Borrower shall fail to meet the financial ratio covenant specified in Section 5.B.(1), or shall decrease its rates in breach of the covenant specified in Section 5.B.(3) hereof;

D. Other Covenants. Default by the Borrower in the observance or performance of any other covenant or agreement contained in this Agreement or in the Note, which shall remain unremedied for thirty (30) calendar days after written notice thereof shall have been given to the Borrower by CFC;

E. Corporate Existence. Borrower shall forfeit or otherwise be deprived of its corporate charter, franchises, permits, easements, consents or licenses required to carry on any material portion of its business;

F. Other Obligations. Default by the Borrower in the payment of any obligation, whether direct or contingent, for borrowed money or in the performance or observance of the terms of any instrument pursuant to which such obligation was created or securing such obligation;

G. Involuntary Bankruptcy. An involuntary case or other proceeding shall be commenced against the Borrower seeking liquidation, reorganization or other relief with respect to it or its debts under bankruptcy, insolvency or other similar law now or hereafter in effect or seeking the appointment of a trustee, receiver, liquidator, custodian or other similar official of it or any substantial part of its property and such involuntary case or other proceeding shall continue without dismissal or stay for a period of thirty (30) consecutive days; or an order for relief shall be entered against Borrower under the federal bankruptcy laws or applicable state law as now or hereafter in effect;

H. Insolvency. Borrower shall commence a voluntary case or other proceeding seeking liquidation, reorganization or other relief with respect to itself or its debts under any bankruptcy, insolvency or other similar law now or hereafter in effect or seeking the appointment of a trustee, receiver, liquidator, custodian or other similar official of it or any substantial part of its property, or shall consent to any such relief or to the appointment of or taking possession by any such official in an involuntary case or proceeding commenced against it, or shall make a general assignment for the benefit of creditors, or shall admit in writing its inability to, or be generally unable to, pay its debts as they become due, or shall take any action to authorize any of the foregoing;

I. Dissolution or Liquidation. Other than as provided in subsections G. or H. above, the dissolution or liquidation of the Borrower, or failure by the Borrower promptly to forestall or remove any execution, garnishment or attachment of such consequence as will impair its ability to continue its business or fulfill its obligations and such execution, garnishment or attachment shall not be vacated within thirty (30) days. The term "dissolution or liquidation of the Borrower", as used in this subsection, shall not be construed to include the cessation of the corporate existence of the Borrower resulting either from a merger or consolidation of the Borrower into or with another corporation following a transfer of all or substantially all its assets as an entirety,

under the conditions permitting such actions, including required approval from CFC under the terms hereof.

J. Final Judgment. A final judgment in excess of \$100,000 shall be entered against the Borrower and shall remain unsatisfied or without a stay for a period of thirty (30) days.

ARTICLE VII

REMEDIES

Section 7.01 General Remedies. In addition to the actions described in Section 7.02 and 7.03 hereof, if any Event of Default shall occur after the date of this Agreement and shall not have been remedied within the applicable time periods prescribed herein, then CFC may declare all amounts due on account of this Agreement or the Note to be immediately due and payable and may pursue all other rights and remedies available to CFC that are contemplated by this Agreement in the manner, upon the conditions, and with the effect provided in this Agreement, including but not limited to, a suit for specific performance, injunctive relief or damages. Nothing herein shall limit the right of CFC to pursue all rights and remedies available to a creditor following the occurrence of an Event of Default. Each right, power and remedy of CFC shall be cumulative and concurrent, and recourse to one or more rights or remedies shall not constitute a waiver of any other right, power or remedy.

Section 7.02 No Further Advances. If any of the Events of Default shall occur after the date of this Agreement and shall not have been remedied, then CFC, without incurring any liability on its part to the Borrower or to any other person, may refuse to make any Advances hereunder.

Section 7.03. Right of Setoff. Upon the occurrence and during the continuance of any Event of Default, CFC is hereby authorized at any time and from time to time, without prior notice to the Borrower, to exercise rights of setoff or recoupment and apply any and all amounts held, or hereby held, by CFC or owed to the Borrower or for the credit on account of the Borrower against any and all of the obligations of the Borrower now or hereafter existing hereunder or under the Note. CFC agrees to notify the Borrower promptly after any such setoff or recoupment and the application thereof; provided that the failure to give such notice shall not affect the validity of such setoff, recoupment or application. The rights of CFC under this Section 7.03. are in addition to any other rights and remedies (including other rights of setoff or recoupment) which CFC may have. Borrower waives all rights of setoff, deduction, recoupment and counterclaim.

ARTICLE VIII

MISCELLANEOUS

Section 8.1. Notices. All notices, requests and other communications provided for herein including, without limitation, any modifications of, or waivers, requests or consents under, this Agreement shall be given or made in writing (including, without limitation, by telecopy) and delivered to the intended recipient at the "Address for Notices" specified below; or, as to any party, at such other address as shall be designated by such party in a notice to each other party. Except as otherwise provided in this Agreement, all such communications shall be deemed to have been duly given when personally delivered or, in the case of a telecopied or mailed notice, upon receipt, in each case given or addressed as provided for herein. The Addresses for Notices of the respective parties are as follows:

National Rural Utilities Cooperative Finance Corporation
2201 Cooperative Way
Herndon, Virginia 20171
Fax: (703) 709-6776

Attention: Senior Vice President, Member Services

The Borrower:
The address set forth in Schedule 1 hereto

Section 8.2. Expenses. The Borrower will pay all costs and expenses of CFC, including reasonable fees of counsel, incurred in connection with the enforcement of this Agreement and the Note and the other instruments provided for herein or with the preparation for such enforcement if CFC has reasonable grounds to believe that such enforcement may be necessary.

Section 8.3. No Waiver. No failure on the part of CFC to exercise, and no delay in exercising, any right under this Agreement or the Note shall operate as a waiver thereof nor shall any single or partial exercise by CFC of any right under this Agreement or the Note preclude any other or further exercise thereof or the exercise of any other right. No waiver of any provision of this Agreement or the Note and no consent to any departure by Borrower therefrom shall in any event be effective unless the same shall be in writing by the party granting such waiver or consent.

SECTION 8.4. GOVERNING LAW; SUBMISSION TO JURISDICTION; WAIVER OF JURY TRIAL.

(a) THE PERFORMANCE AND CONSTRUCTION OF THIS AGREEMENT AND THE NOTE SHALL BE GOVERNED BY, AND CONSTRUED IN ACCORDANCE WITH, THE LAWS OF THE COMMONWEALTH OF VIRGINIA.

(b) BORROWER HEREBY SUBMIT(S) TO THE NONEXCLUSIVE JURISDICTION OF THE UNITED STATES COURTS LOCATED IN VIRGINIA AND OF ANY STATE COURT SO LOCATED FOR PURPOSES OF ALL LEGAL PROCEEDINGS ARISING OUT OF OR RELATING TO THIS AGREEMENT OR THE TRANSACTIONS CONTEMPLATED HEREBY. BORROWER IRREVOCABLY WAIVES, TO THE FULLEST EXTENT PERMITTED BY APPLICABLE LAW, ANY OBJECTION THAT IT MAY NOW OR HEREAFTER HAVE TO THE ESTABLISHING OF THE VENUE OF ANY SUCH PROCEEDING BROUGHT IN SUCH A COURT AND ANY CLAIM THAT ANY SUCH PROCEEDING HAS BEEN BROUGHT IN AN INCONVENIENT FORUM.

(c) EACH OF THE BORROWER AND CFC HEREBY IRREVOCABLY WAIVES, TO THE FULLEST EXTENT PERMITTED BY APPLICABLE LAW, ANY AND ALL RIGHT TO TRIAL BY JURY IN ANY LEGAL PROCEEDING ARISING OUT OF OR RELATING TO THIS AGREEMENT OR THE TRANSACTIONS CONTEMPLATED HEREBY.

Section 8.5. Amendments. No amendment of any provision of this Agreement or the Note shall in any event be effective unless the same shall be in writing and signed by both CFC and the Borrower.

Section 8.6. Merger and Integration. This Agreement and the attached exhibits and matters incorporated by reference contain the entire agreement of the parties hereto with respect to the matters covered and the transactions contemplated hereby.

Section 8.7. Headings. The headings and sub-headings contained in the titling of this Agreement are intended to be used for convenience only and do not constitute part of this Agreement.

Section 8.8. Severability. If any term, provision or condition, or any part thereof, of this Agreement or the Note shall for any reason be found or held invalid or unenforceable by any governmental agency or court of competent jurisdiction, such invalidity or unenforceability shall not affect the remainder of such term, provision or condition nor any other term, provision or condition, and this Agreement and the Note shall survive and be construed as if such invalid or unenforceable term, provision or condition had not been contained therein.

Section 8.9. Schedule 1. Schedule 1 attached hereto is an integral part of this Agreement and is incorporated by reference herein.

IN WITNESS WHEREOF, the parties hereto have caused this Agreement to be duly executed as of the day and year first above written.

ARIZONA ELECTRIC POWER COOPERATIVE, INC.

(SEAL)

By: *Donald W. Kimball*
DONALD W. KIMBALL

Title: EXECUTIVE VICE PRESIDENT &
CHIEF EXECUTIVE OFFICER

Attest: *Donald Kimball*
Secretary

NATIONAL RURAL UTILITIES
COOPERATIVE FINANCE CORPORATION

(SEAL)

By: *Ann Shankroff*
Assistant Secretary-Treasurer

Attest: *Charles Wilson*
Assistant Secretary-Treasurer

ANN SHANKROFF

CHARLES WILSON

SCHEDULE 1

1. The CFC Commitment is Four Hundred Thirty-Seven Thousand Six Hundred Fifteen Dollars (\$437,615.00), representing the equity purchase requirement with respect to Corresponding Loan No. AZ028-A-9034.
2. The Borrower's chief place of business and its address for notices is 1000 South Highway 80, Benson, Arizona 85602, Attention: General Manager, Fax: (520) 586-5343.
3. The date of the Borrower's balance sheet referred to in Section 2.1.D. is December 31, 2004.