

Annual report dated August 31, 2007 enclosed.

Schwab Tax-Free Bond Funds

Schwab Tax-Free
YieldPlus FundTM

Schwab Tax-Free
Bond FundTM
*(formerly Schwab
Long-Term Tax-Free
Bond FundTM)*

Schwab California
Tax-Free YieldPlus FundTM

Schwab California
Tax-Free Bond FundTM
*(formerly Schwab
California Long-Term
Tax-Free Bond FundTM)*

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Current performance may be substantially
different from what is contained in this report.
Please click [here](#) for more current fund
performance and other information.

This report is not authorized for distribution to
prospective investors unless preceded or
accompanied by a current prospectus.

charles SCHWAB

This page is not part of the shareholder report.

Introducing the Schwab Premier Income Fund[®]

With the potential for more monthly income than a traditional income fund, the Schwab Premier Income Fund targets higher yields.

More Investment Choices: Drawing upon a range of investment choices that goes beyond bonds and CDs, the Schwab Premier Income Fund can invest in more income-producing securities than a traditional income fund.

Disciplined Investment Approach: The fund's flexible investment mix is determined by fund managers who monitor the market and then select securities that offer the most attractive risk-adjusted yield.

Designed for Income: The Schwab Premier Income Fund is a new fund that is designed for investors currently in retirement who are seeking attractive monthly income. The fund has been created for those who seek higher yields and are willing to accept the corresponding increase in risk. The fund is appropriate for those who plan to invest in the fund a minimum of three years.

The Team Behind the Fund: The fund is guided by a team led by Kim Daifotis, chief investment officer and portfolio manager, fixed income. Kim is responsible for Schwab's taxable and municipal bond and money market funds, representing \$160 billion in client assets. On a day-to-day basis, the fund is managed by Matthew Hastings, Andrew Tikofsky, Steven Hung and Alfonso Portillo.

Schwab Premier Income Fund Facts			
Share Class	Minimum Investment	Expense Ratio ¹	Ticker Symbol
Investor	\$100	0.87%	SWIPX
Select	\$50,000	0.72%	SWILX
Institutional	\$500,000	0.63%	SWIIX

¹ Schwab and the investment adviser have agreed to limit the net operating expenses (excluding interest, taxes and certain non-routine expenses) of the Investor Shares, Select Shares, and Institutional Shares to 0.87%, 0.72% and 0.63% respectively through 6/30/09.

To Learn More

For more information on the Schwab Premier Income Fund, call 1-877-369-4626 or visit www.schwab.com/premierincome.

Investors should consider carefully information contained in the prospectus, including investment objectives, risks, charges and expenses. You can request a prospectus by calling Schwab at 800-435-4000. Please read the prospectus carefully before investing. Investment value will fluctuate, and shares, when redeemed, may be worth more or less than original cost.

Bond funds are subject to increase loss of principal during periods of rising interest rates. The Schwab Premier Income Fund can also invest in securities that may subject the fund to additional investment risks such as international and emerging market, small company, and derivative.

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Annual Report
August 31, 2007

Schwab Tax-Free
YieldPlus Fund™

Schwab Tax-Free
Bond Fund™
*(formerly Schwab Long-Term
Tax-Free Bond Fund™)*

Schwab California
Tax-Free YieldPlus Fund™

Schwab California
Tax-Free Bond Fund™
*(formerly Schwab California
Long-Term Tax-Free Bond Fund™)*

charles SCHWAB

Four smart, cost-effective ways investors can use bonds in an asset allocation strategy.

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Performance at a Glance

The performance data quoted represents past performance. Past performance does not guarantee future results. Investment returns and principal value will fluctuate so that an investor's shares may be worth more or less than their original cost. Current performance may be lower or higher than performance data quoted. To obtain performance information current to the most recent month end, please visit www.schwab.com/schwabfunds.

	Total Return for the Report Period
Schwab Tax-Free YieldPlus Fund™ (Ticker Symbol: SWYTX)*	2.34%
Benchmark: Lehman Brothers 1-Year Municipal Bond Index	3.52%
Fund Category: Morningstar Municipal National Short Bond	2.69%
<i>Performance Details</i>	<i>pages 6-7</i>
Schwab Tax-Free Bond Fund™ (Ticker Symbol: SWNTX)	0.82%
Benchmark: Lehman Brothers General Municipal Bond Index	2.30%
Fund Category: Morningstar Municipal National Intermediate Bond	1.73%
<i>Performance Details</i>	<i>pages 8-9</i>
Schwab California Tax-Free YieldPlus Fund™ (Ticker Symbol: SWYCX)	2.16%
Benchmark: Lehman Brothers 1-Year Municipal Bond Index	3.52%
Fund Category: Morningstar Municipal California Intermediate/Short Bond	1.78%
<i>Performance Details</i>	<i>pages 10-11</i>
Schwab California Tax-Free Bond Fund™ (Ticker Symbol: SWCAX)	1.57%
Benchmark: Lehman Brothers General Municipal Bond Index	2.30%
Fund Category: Morningstar Municipal California Intermediate/Short Bond	1.78%
<i>Performance Details</i>	<i>pages 12-13</i>
Minimum Initial Investment ¹	\$ 100

All fund and index figures on this page assume dividends and distributions were reinvested. Index figures do not include trading and management costs, which would lower performance. Indices are unmanaged, and you cannot invest in them directly. Performance results less than one year are not annualized.

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Source for category information: Morningstar, Inc.

* Return for the report period presented in the table differs from the return in the Financial Highlights. This is a result of the calculation of the Financial Highlights return adhering to GAAP presentation.

¹ Please see prospectus for further detail and eligibility requirements.

From the Chairman



Charles Schwab
Chairman

Dear Shareholder,

I want to thank you for entrusting us with your investments. I have been a fan of mutual funds throughout my long investing career. I say this because I firmly believe they are a cost-effective and convenient way for investors to achieve a diversified portfolio. And as we face increasing uncertainty in the world and in global markets, diversification is as important now as it has ever been.

Research has indicated that spreading your money across, and equally important, within, different asset classes, such as stocks, bonds, and cash equivalents, can be the most important factor in determining overall portfolio performance. By maintaining diversification, your portfolio can be better positioned to help you weather the market ups and downs.

With a broad range of investment strategies and styles, Schwab Funds® provides an uncomplicated, effective way to build a well diversified portfolio. You can choose from an array of funds across a range of investment objectives and styles. If you prefer a single investment solution, we offer complete asset allocation funds based on either risk tolerance or time horizon.

Here at Schwab, our goal is to help you reach your financial goals. With quality funds and services, backed by the guidance and support you need—whatever type of investor you are—we can help you be financially fit today and in the future.

Thank you for investing with us.

Sincerely,

A handwritten signature in cursive script that reads "Charles Schwab". The signature is written in dark ink and is positioned below the word "Sincerely,".

From the President



Randall W. Merk is President and CEO of Charles Schwab Investment Management, Inc. and the funds covered in this report. He joined the firm in 2002 and has held a variety of executive positions at Schwab.

Dear Shareholder,

As I return to my role as President and CEO of Charles Schwab Investment Management, I would like to give you my perspective on the current market environment.

For over five years, global equity and credit markets had been relatively tame with regards to volatility. Liquidity was ample, corporate profits stable, and investors increasingly became more bullish. However, recent subprime mortgage issues have sparked a chain reaction within the credit markets, causing a reemergence of volatility.

Understandably, many investors are nervous, which has led some to react on emotion rather than sound investment principles. The later part of the report period saw investors fleeing to “safe haven” investments, such as U.S. Treasuries, as riskier securities experienced downward price pressures. However, as the August market crisis abated following aggressive moves to lower short term rates by the Federal Reserve, many market participants found themselves lurching out of cash and Treasury securities and back again into stocks and corporate bonds. Timing the market can be a risky and frustrating experience.

In the end, the basic reasons for keeping bond investments in a portfolio — income and lower volatility — are always worth remembering. We at Schwab have always believed your best protection against swings in market volatility is to maintain a well-diversified investment portfolio. If you would like help evaluating your portfolio or if you have not yet created a plan, you might want to schedule a complimentary portfolio consultation by calling Schwab at 1-800-308-1486.

I speak for all of us at Schwab when I say our goal is to give you the financial products, guidance, and personal relationship you need to succeed.

Thank you for investing in Schwab Funds®.

Sincerely,

Randall W. Merk

The Investment Environment



Kim Daifotis, CFA, a senior vice president and chief investment officer, fixed income, has day-to-day responsibility for the management of the funds.

Over the past year, global equity and credit markets have benefited from ample liquidity, earnings growth, and relatively low volatility. The ease at which companies could finance debt led to a record level of stock buybacks, acquisitions, and private equity buyouts in 2006 and into 2007. In addition, bullish investors pushed stocks higher, as evidenced by the Dow Jones Industrial Average and the broader S&P 500 reaching all-time highs in July 2007. However, the housing market slowdown and more recently, turmoil in the subprime mortgage market, have had a ripple effect throughout the economy. Several key issues weighed on investors, namely, the continued deterioration in the housing market, tightening of lending standards, and the lagged effects of monetary policy.

U.S. economic growth slowed considerably over the report period, consistent with the Federal Reserve's (the Fed) engineered soft landing. Throughout their statements, they indicated that the economy would grow at a more moderate rate as a result of prior rate increases, lagged effects of higher energy prices, and a cooling housing market. Consistent with their reports, GDP grew at a sub-par pace for four consecutive quarters. However, GDP grew at an improved annual rate of 4.0% in the second quarter of 2007.

The housing market has been a significant headwind for the U.S. economy and continued to provide mixed signals with regards to a recovery. Initial concerns that troubles from the housing market would spill over to the rest of the economy became more pronounced throughout the report period. Declines in housing starts, as well as new and existing home sales, caused builders and many mortgage lenders to layoff thousands of employees. Over the course of the report period, the level of inventories rose to a record high, equal to 9.6 months of supply based on the current sales rate.

Among the effects of the subprime mortgage issue has been a tightening of lending standards and reduced liquidity in the market. Although relaxed access to easy credit and liquidity led subprime mortgages to find their way into securitized structures, the increasing frequency of loan defaults experienced by subprime borrowers have stressed securities that hold these mortgages, causing wider spreads and higher risk. February's spike in volatility gave a first sign that subprime issues had emerged, potentially threatening credit markets. As a result of increasing subprime foreclosures during the period, liquidity in the market for these riskier securities dried up, putting some financial institutions heavy in securities with underlying subprime loans into financial turmoil. While the Fed helped ease

Yields of Municipal Securities: Effective Yields of Five-Year and 30-Year Municipal Bonds



Yields, or interest rates, represent the cost of borrowing money. Rapid economic growth, waning investor interest in bonds, an increase in the issuance of bonds, or the expectation of higher inflation can drive rates up, while the opposite conditions can push rates down.

Data source: Bloomberg L.P.

liquidity issues by pumping money into the economy and using the discount window to reduce rates, many lenders reduced or cancelled certain subprime lending programs altogether.

Part of the reason for the recent turmoil in the financial markets can be explained by monetary policy. It is generally believed that the effects of Fed rate hikes on the economy have a lag of between three and 18 months, yet with most of the impact felt by the twelfth month. Since the first signs of “repricing of risk” premiums paid for securities riskier than U.S. Treasuries occurred in February of 2007, the 12-month lag would indicate that the effects of the hikes in the Fed funds target rate to both 4.50% and 4.75% in early 2006 had finally hit the market.

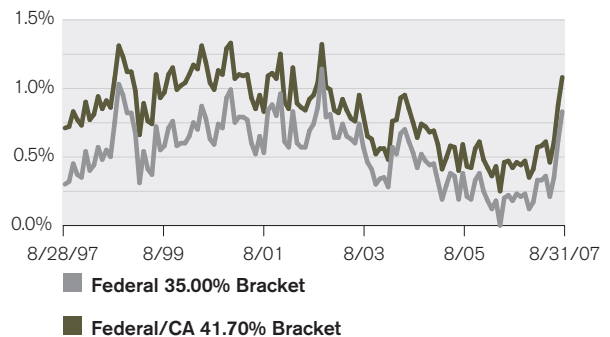
During the report period, the Fed held the Fed funds target rate at 5.25%. Noting that the economy would grow at a more moderate pace, they maintained that their primary concern was that inflation would fail to moderate due to the high level of resource utilization. Core Personal Consumption Expenditures (PCE), the Fed’s primary index used to monitor inflation, vacillated near the upper end of the Fed’s unofficial comfort zone of 1%-2%. However, as economic growth slowed, inflationary pressures eased during the period, with the most current reading in July 2007 coming in at an annually adjusted 1.9%. Although relatively stable throughout the period, employment began to show signs of weakening, as the unemployment rate ticked up to 4.6% from 4.5% in June 2007. Temporary employment, a forward-looking indicator, trended downward, totaling a loss of 52,500 jobs as of July 2007.

Over the period, treasury rates declined, while the tax-exempt market saw rates increase, particularly on the long end. This caused a steepening in the tax-exempt yield curve and, consequently, led municipal securities to substantially underperform treasury securities. The depreciation in tax-exempt securities at the end of the period seemed to follow the drop in valuations on domestic and global assets, which was primarily based on the slump in the U.S. housing market and lack of overall market liquidity, and not by a decline in municipal issuers’ credit quality. Additionally, municipal new issuance volume continued to keep a record pace versus the record levels set in 2005.

Yield Advantage of Munis over Treasuries: For Five-Year bonds; Tax Brackets Shown are the Highest Applicable

This chart shows how much more the average five-year muni yielded than the average five-year Treasury after federal (or combined California and federal) income tax.

Data source: Bloomberg L.P.



Nothing in this report represents a recommendation of a security by the investment adviser. Manager views and portfolio holdings may have changed since the report date.

Schwab Tax-Free YieldPlus Fund™



Kim Daifotis CFA, a senior vice president and chief investment officer, fixed income, has day-to-day responsibility for the management of the fund.

The Schwab Tax-Free YieldPlus Fund returned 2.34% for the report period, underperforming its benchmark, the Lehman Brothers 1-Year Municipal Bond Index, which was up 3.52%. During the period, the fund continued to seek out securities with good underlying credit quality and solid risk-adjusted spreads. Also, the fund maintained a duration of one year or less through security selection and by utilizing treasury futures. However, this detracted from performance, as higher grade securities outperformed lower rated bonds and treasuries securities substantially outperformed municipal bonds.

During the latter part of the reporting period, the lack of liquidity in the market contributed significantly in limiting many newer market participants from actively trading, causing yields on municipal bonds to increase. Though the municipal yield curve from 1-30 years averaged 65 basis points earlier in the report period, it later steepened to 100 basis points, as market volatility weighed on investors. The month of August, in particular, was highlighted by liquidity concerns as well as perceived credit weakness in the municipal market, which hurt the performance of the higher yielding positions in the fund. Consequently, the fixed income market experienced a flight to safety, in which U.S. Treasury obligations were the only beneficiary.

As of 8/31/07:

Portfolio Composition % of Investments

These tables show three different views of the fund's portfolio: by type of security, credit quality of the security and remaining maturity.

By Security Type		By Credit Quality ¹		By Maturity	
Floating Rate Bonds	30.7%	AAA	20.5%	0 - 6 Months	63.1%
Revenue Bonds	30.1%	AA	34.2%	7-18 Months	10.0%
Auction Rate Securities	15.5%	A	17.3%	More than 18 Months	26.9%
Variable Rate Demand Notes	10.7%	BBB	8.4%		
Muni Notes	7.2%	Short-Term Ratings	15.8%		
General Obligation Bonds	5.8%	Unrated Securities	3.8%	Weighted Average Maturity	0.8 yrs
				Weighted Average Effective Duration	0.8 yrs
		Weighted Average Credit Quality	AA		

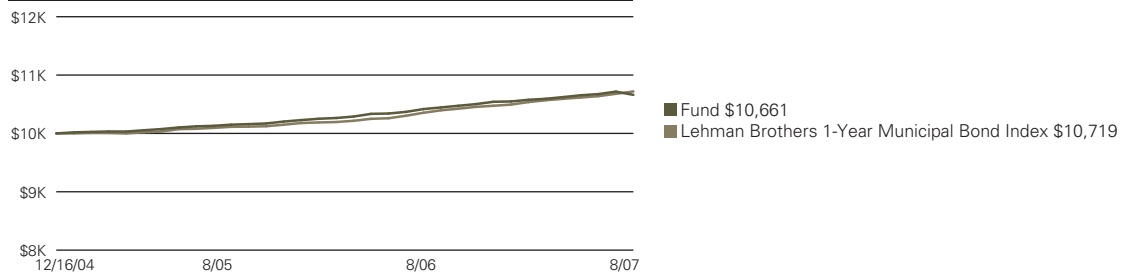
Portfolio holdings may have changed since the report date.

¹ Based on ratings from Moody's. Where Moody's ratings are not available, Standard & Poor's ratings are used. The fund may use different ratings provided by other ratings agencies for purposes of determining compliance with the fund's investment policies.

Performance Summary as of 8/31/07

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Performance of a Hypothetical \$10,000 Investment¹

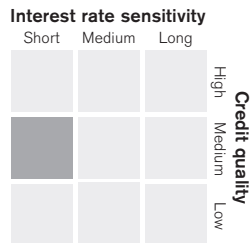


Average Annual Total Returns^{1,2,3}

	1 Year	Since Inception
Fund: Schwab Tax-Free YieldPlus Fund™ (12/16/04)*	2.34%	2.39%
Benchmark: Lehman Brothers 1-Year Municipal Bond Index	3.52%	2.59%
Fund Category: Morningstar Municipal National Short Bond	2.69%	2.19%

Fund Expense Ratios⁴: Net 0.49%; Gross 0.53%

Style Assessment⁵



Yields

30-Day SEC Yield ^{1,3}	3.85%
Taxable-Equivalent Yield ⁶	5.92%
12-Month Distribution Yield ^{1,3}	2.32%

All total returns on this page assume dividends and distributions were reinvested. Index figures do not include trading and management costs, which would lower performance. Indices are unmanaged, and you cannot invest in them directly. Performance results less than one year not annualized.

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² Performance does not reflect the deduction of taxes that a shareholder would pay on fund distributions or on the redemption of fund shares.

³ Source for category information: Morningstar, Inc.

⁴ Fund expenses may have been partially absorbed by CSIM and Schwab. Without these reductions, the total return may have been lower.

⁵ Per prospectus effective 11/15/06, as amended 8/6/07. Net Expense: Expenses reduced by a contractual fee waiver. Gross Expense: Does not reflect the effect of contractual fee waivers.

⁶ Source: Morningstar, Inc. Interest rate sensitivity and credit quality are two main components of bond performance. The assessment reflects the fund's portfolio as of 8/31/07 and is not a precise indication of risk or performance—past, present or future. Definitions of style assessments: Sensitivity (measured as duration): short, up to 3.5 years; Medium, more than 3.5 years to less than six years; Long, six years or greater. Credit quality: High, AA or better; Medium, A or BBB; Low, BB or lower.

⁷ This is the taxable-equivalent 30-day SEC yield for a hypothetical investor in the highest federal tax bracket (35.00%). Your tax rate may be different.

Schwab Tax-Free Bond FundTM



Kim Daifotis CFA, a senior vice president and chief investment officer, fixed income, has day-to-day responsibility for the management of the fund.

The Schwab Tax-Free Bond Fund returned 0.82% for the period, and underperformed its benchmark, the Lehman Brothers General Municipal Bond Index, which returned 2.30%. During the period, the fund continued to seek out securities with good underlying credit quality and solid risk-adjusted spreads. Contributing to the underperformance of the fund was an overweight of longer duration securities, as well as lower investment grade securities relative to the benchmark.

During the latter part of the reporting period, the lack of liquidity in the market contributed significantly in limiting many newer market participants from actively trading, causing yields on municipal bonds to increase. Though the municipal yield curve from 1-30 years averaged 65 basis points earlier in the report period, it later steepened to 100 basis points, as market volatility weighed on investors. The month of August, in particular, was highlighted by liquidity concerns as well as perceived credit weakness in the municipal market, which hurt the performance of the higher yielding positions in the fund. Consequently, the fixed income market experienced a flight to safety, in which U.S. Treasury obligations were the only beneficiary.

As of 8/31/07:

Portfolio Composition % of Investments

These tables show three different views of the fund's portfolio: by type of security, credit quality of the security and remaining maturity.

By Security Type		By Credit Quality ¹		By Maturity	
Revenue Bonds	74.6%	AAA	66.8%	0-1 Year	6.8%
General Obligation Bonds	21.3%	AA	18.5%	2-10 Years	24.1%
Variable Rate Demand Notes	4.1%	A	6.0%	11-20 Years	48.5%
		BBB	2.6%	21-30 Years	20.6%
		Short-Term Ratings	4.0%		
		Unrated Securities	2.1%		
		Weighted Average Credit Quality	AAA	Weighted Average Maturity	9.8 yrs
				Weighted Average Effective Duration	6.9 yrs

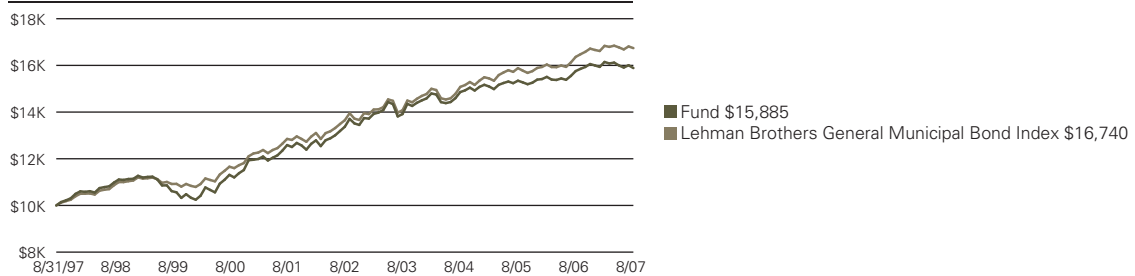
Portfolio holdings may have changed since the report date.

¹ Based on ratings from Moody's. Where Moody's ratings are not available, Standard & Poor's ratings are used. The fund may use different ratings provided by other ratings agencies for purposes of determining compliance with the fund's investment policies.

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Performance of a Hypothetical \$10,000 Investment¹

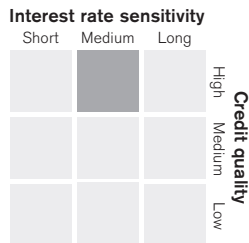


Average Annual Total Returns^{1,2,3}

	1 Year	5 Years	10 Years
Fund: Schwab Tax-Free Bond Fund™ (9/11/92)	0.82%	3.49%	4.74%
Benchmark: Lehman Brothers General Municipal Bond Index	2.30%	4.16%	5.28%
Fund Category: Morningstar Municipal National Intermediate Bond	1.73%	3.05%	4.24%

Fund Expense Ratios⁴: Net 0.49%; Gross 0.69%

Style Assessment⁵



Yields

30-Day SEC Yield ^{1,3}	4.37%
30-Day SEC Yield-No Waiver ^{1,6}	4.16%
Taxable-Equivalent Yield ⁷	6.72%
12-Month Distribution Yield ^{1,3}	0.85%

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² Source for category information: Morningstar, Inc.

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⁵ Source: Morningstar, Inc. Interest rate sensitivity and credit quality are two main components of bond performance. The assessment reflects the fund's portfolio as of 8/31/07 and is not a precise indication of risk or performance—past, present or future. Definitions of style assessments: Sensitivity (measured as duration): short, up to 3.5 years; Medium, more than 3.5 years to less than six years; Long, six years or greater. Credit quality: High, AA or better; Medium, A or BBB; Low, BB or lower.

⁶ Yield if fund expenses had not been partially absorbed by CSIM and Schwab.

⁷ This is the taxable-equivalent 30-day SEC yield for a hypothetical investor in the highest federal tax bracket (35.00%). Your tax rate may be different.

Schwab California Tax-Free YieldPlus Fund™



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The Schwab California Tax-Free YieldPlus Fund Investor Shares returned 2.16% for the report period, underperforming its benchmark, the Lehman Brothers 1-Year Municipal Bond Index, which was up 3.52%. During the period, the fund continued to seek out securities with good underlying credit quality and solid risk-adjusted spreads. Also, the fund maintained a duration of one year or less through security selection and by utilizing treasury futures. However, this detracted from performance, as higher grade securities outperformed lower rated bonds and treasuries securities substantially outperformed municipal bonds.

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As of 8/31/07:

Portfolio Composition % of Investments

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By Security Type		By Credit Quality ¹		By Maturity	
Auction Rate Securities	34.0%	AAA	32.2%	0-6 Months	63.0%
Floating Rate Bonds	22.7%	AA	11.7%	7-18 Months	9.9%
Variable Rate Demand Notes	18.0%	A	24.4%	19-30 Months	3.5%
General Obligation Bonds	11.9%	BBB	2.6%	More than 30 Months	23.6%
Revenue Bonds	6.9%	Short-Term Ratings	28.5%		
Muni Notes	6.5%	Unrated Securities	0.6%		
		Weighted Average Credit Quality	AA	Weighted Average Maturity	1.3 yrs
				Weighted Average Effective Duration	1.0 yrs

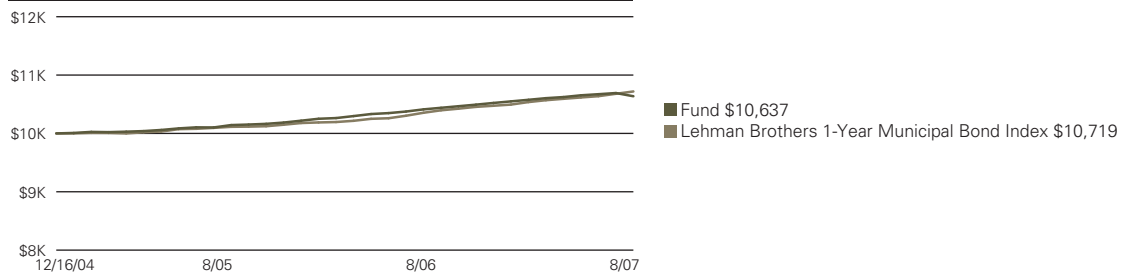
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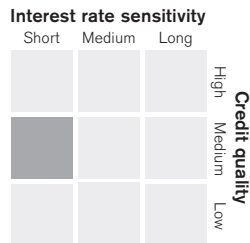


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	1 Year	Since Inception
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Benchmark: Lehman Brothers 1-Year Municipal Bond Index	3.52%	2.59%
Fund Category: Morningstar Municipal California Intermediate/Short Bond	1.78%	2.37%

Fund Expense Ratio⁴: 0.46%

Style Assessment⁵



Yields

30-Day SEC Yield ^{1,3}	3.68%
Taxable-Equivalent Yield ⁶	6.31%
12-Month Distribution Yield ^{1,3}	1.80%

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⁶ This is the taxable-equivalent 30-day SEC yield for a hypothetical investor in the highest combined federal and California tax bracket (41.70%).

Schwab California Tax-Free Bond FundTM



Kim Daifotis CFA, a senior vice president and chief investment officer, fixed income, has day-to-day responsibility for the management of the fund.

The Schwab California Tax-Free Bond Fund had a positive return of 1.57% for the period, and underperformed its benchmark, the Lehman Brothers General Municipal Bond Index, which returned 2.30% for the period. During the period, the fund continued to seek out securities with good underlying credit quality and solid risk-adjusted spreads. Contributing to the underperformance of the fund was an overweight of longer duration securities, as well as lower investment grade securities relative to the benchmark.

During the latter end of the reporting period, the lack of liquidity in the market contributed significantly in limiting many newer market participants from actively trading, causing yields on municipal bonds to increase. Though the municipal yield curve from 1-30 years averaged 65 basis points earlier in the report period, it later steepened to 100 basis points, as market volatility weighed on investors. The month of August, in particular, was highlighted by liquidity concerns as well as perceived credit weakness in the municipal market, which hurt the performance of the higher yielding positions in the fund. Consequently, the fixed income market experienced a flight to safety, in which U.S. Treasury obligations were the only beneficiary.

As of 8/31/07:

Portfolio Composition % of Investments

These tables show three different views of the fund's portfolio: by type of security, credit quality of the security and remaining maturity.

By Security Type		By Credit Quality ¹		By Maturity	
Revenue Bonds	76.7%	AAA	53.9%	0-1 Year	11.1%
General Obligation Bonds	13.1%	AA	3.6%	2-10 Years	26.2%
Variable Rate Demand Notes	10.2%	A	23.0%	11-20 Years	36.3%
		BBB	8.8%	21-30 Years	26.4%
		Short-Term Ratings	9.9%	More than 30 Years	0.0%
		Unrated Securities	0.8%		
		Weighted Average Credit Quality	AA	Weighted Average Maturity	8.9 yrs
				Weighted Average Effective Duration	5.9 yrs

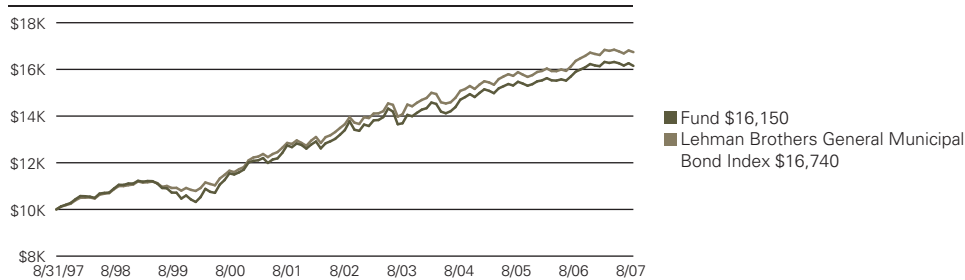
Portfolio holdings may have changed since the report date.

¹ Based on ratings from Moody's. Where Moody's ratings are not available, Standard & Poor's ratings are used. The fund may use different ratings provided by other ratings agencies for purposes of determining compliance with the fund's investment policies.

Performance Summary as of 8/31/07

The performance data quoted represents past performance. Past performance does not guarantee future results. Investment returns and principal value will fluctuate so that an investor's shares may be worth more or less than their original cost. Current performance may be lower or higher than performance data quoted. To obtain performance information current to the most recent month end, please visit www.schwab.com/schwabfunds.

Performance of a Hypothetical \$10,000 Investment¹

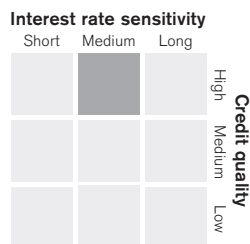


Average Annual Total Returns^{1,2,3}

	1 Year	5 Years	10 Years
Fund: Schwab California Tax-Free Bond Fund™ (2/24/92)	1.57%	3.80%	4.92%
Benchmark: Lehman Brothers General Municipal Bond Index	2.30%	4.16%	5.28%
Fund Category: Morningstar Municipal California Intermediate/Short Bond	1.78%	2.69%	4.07%

Fund Expense Ratios⁴: Net 0.49%; Gross 0.60%

Style Assessment⁵



Yields

30-Day SEC Yield ^{1,3}	4.47%
30-Day SEC Yield-No Waiver ^{1,6}	4.34%
Taxable-Equivalent Yield ⁷	7.67%
12-Month Distribution Yield ^{1,3}	1.02%

All total returns on this page assume dividends and distributions were reinvested. Index figures do not include trading and management costs, which would lower performance. Indices are unmanaged, and you cannot invest in them directly. Performance results less than one year not annualized.

¹ Performance does not reflect the deduction of taxes that a shareholder would pay on fund distributions or on the redemption of fund shares.

² Source for category information: Morningstar, Inc.

³ Fund expenses may have been partially absorbed by CSIM and Schwab. Without these reductions, the total return may have been lower.

⁴ Per prospectus effective 11/15/06, as amended 8/6/07. Net Expense: Expenses reduced by a contractual fee waiver. Gross Expense: Does not reflect the effect of contractual fee waivers.

⁵ Source: Morningstar, Inc. Interest rate sensitivity and credit quality are two main components of bond performance. The assessment reflects the fund's portfolio as of 8/31/07 and is not a precise indication of risk or performance—past, present or future. Definitions of style assessments: Sensitivity (measured as duration): short, up to 3.5 years; Medium, more than 3.5 years to less than six years; Long, six years or greater. Credit quality: High, AA or better; Medium, A or BBB; Low, BB or lower.

⁶ Yield if fund expenses had not been partially absorbed by CSIM and Schwab.

⁷ This is the taxable-equivalent 30-day SEC yield for a hypothetical investor in the highest combined federal and California tax bracket (41.70%).

Fund Expenses (Unaudited)

Examples for a \$1,000 Investment

As a fund shareholder, you incur two types of costs: transaction costs, such as redemption fees; and, ongoing costs, such as management fees, transfer agent and shareholder services fees, and other fund expenses.

The expense examples below are intended to help you understand your ongoing cost (in dollars) of investing in a fund and to compare this cost with the ongoing cost of investing in other mutual funds. These examples are based on an investment of \$1,000 invested for six-months beginning March 1, 2007 and held through August 31, 2007.

Actual Return lines in the table below provide information about actual account values and actual expenses. You may use this information, together with the amount you invested, to estimate the expenses that you paid over the period. To do so, simply divide your account value by \$1,000 (for example, an \$8,600 account value \div \$1,000 = 8.6), then multiply the result by the number given for your fund or share class under the heading entitled 'Expenses Paid During Period'.

Hypothetical Return lines in the table below provide information about hypothetical account values and hypothetical expenses based on a fund's or share class' actual expense ratio and an assumed return of 5% per year before expenses. Because the return used is not an actual return, it may not be used to estimate the actual ending account value or expenses you paid for the period.

You may use this information to compare the ongoing costs of investing in the fund and other funds. To do so, compare this 5% hypothetical example with the 5% hypothetical examples that appear in the shareholder reports of the other funds.

Please note that the expenses shown in the table are meant to highlight your ongoing costs only, and do not reflect any transactional costs, such as redemption fees. Therefore, the hypothetical return lines of the table are useful in comparing ongoing costs only, and will not help you determine the relative total costs of owning different funds. In addition, if these transactional costs were included, your costs would have been higher.

	Expense Ratio ¹ (Annualized)	Beginning Account Value at 3/1/07	Ending Account Value (Net of Expenses) at 8/31/07	Expenses Paid During Period ² 3/1/07 - 8/31/07
Schwab Tax-Free YieldPlus Fund™				
Actual Return	0.49%	\$1,000	\$1,008.10	\$2.48
Hypothetical 5% Return	0.49%	\$1,000	\$1,022.74	\$2.50
Schwab Tax-Free Bond Fund™				
Actual Return	0.54% ³	\$1,000	\$ 983.80	\$2.70 ³
Hypothetical 5% Return	0.54% ³	\$1,000	\$1,022.48	\$2.75 ³
Schwab California Tax-Free YieldPlus Fund™				
Actual Return	0.45%	\$1,000	\$1,005.80	\$2.28
Hypothetical 5% Return	0.45%	\$1,000	\$1,022.94	\$2.29
Schwab California Tax-Free Bond Fund™				
Actual Return	0.53% ³	\$1,000	\$ 989.60	\$2.66 ³
Hypothetical 5% Return	0.53% ³	\$1,000	\$1,022.53	\$2.70 ³

¹ Based on the most recent six-month expense ratio; may differ from the expense ratio provided in Financial Highlights.

² Expenses for each fund or share class are equal to its annualized expense ratio, multiplied by the average account value over the period, multiplied by 184 days of the period, and divided by 365 days of the fiscal year.

³ Effective May 7, 2007, Schwab and investment adviser agreed to limit the fund's net operating expenses (excluding interest, taxes and certain non-routing expenses) to 0.49% for so long as the investment adviser is the adviser to the fund. Based on this expense ratio, 'Expenses Paid During Period' would be \$2.45 based on Actual Return and \$2.50 based on Hypothetical 5% return, respectively, for Tax Free Bond Fund, \$2.46 based on Actual Return and \$2.50 based on Hypothetical 5% return, respectively, for California Tax-Free Bond Fund.

Schwab Tax-Free YieldPlus FundTM

Financial Statements

Financial Highlights

	9/1/06- 8/31/2007 ¹	9/1/05- 8/31/06	12/16/04 ² 8/31/05
Per Share Data(\$)			
Net asset value at beginning of period	9.96	9.97	10.00
Income from investment operations:			
Net investment income	0.33	0.28	0.16
Net realized and unrealized losses	(0.09)	(0.01)	(0.03)
Total income from investment operations	0.24	0.27	0.13
Less distributions:			
Distributions from net investment income	(0.33)	(0.28)	(0.16)
Net asset value at end of period	9.87	9.96	9.97
Total return (%)	2.45	2.73	1.31 ³
Ratios/Supplemental Data (%)			
Ratios to average net assets:			
Net operating expenses	0.49	0.49	0.28 ⁴
Gross operating expenses	0.51	0.53	0.54 ⁴
Net investment income	3.34	2.81	2.33 ⁴
Portfolio turnover rate	45	55	18 ³
Net assets, end of period (\$ x 1,000,000)	654	489	435

¹ Effective on August 6, 2007, all outstanding Investor Shares were converted into Select Shares. The figures in the Financial Highlights reflect only the remaining share class.

² Commencement of operations.

³ Not annualized.

⁴ Annualized.

Portfolio Holdings as of August 31, 2007

This section shows all the securities in the fund's portfolio and their value as of the report date.

The fund files its complete schedule of portfolio holdings with the SEC for the first and third quarters of each fiscal year on Form N-Q. The fund's Form N-Q is available on the SEC's website at <http://www.sec.gov> and may be viewed and copied at the SEC's Public Reference Room in Washington, D.C. Call 1-800-SEC-0330 for information on the operation of the Public Reference Room. The schedule of portfolio holdings filed on a fund's most recent Form N-Q is also available by visiting Schwab's website at www.schwab.com/schwabfunds.

For fixed rate obligations, the rate shown is the interest rate (the rate established when the obligation was issued) and the maturity date shown is the stated legal maturity. For variable-rate obligations, the rate shown is the rate as of the report date, and the maturity date shown is the next interest rate change date.

Holdings by Category	Cost (\$ x 1,000)	Value (\$ x 1,000)
45.0% Fixed-Rate Obligations	295,180	294,308
54.0% Variable-Rate Obligations	358,613	353,564
99.0% Total Investments	653,793	647,872
1.0% Other Assets and Liabilities		6,343
100.0% Net Assets		654,215

Issuer Project Type of Security, Series	Rate	Maturity Date	Face Amount (\$ x 1,000)	Value (\$ x 1,000)
Fixed-Rate Obligations 45.0% of net assets				

ALABAMA 0.6%**Birmingham Special Care Facilities Finance Auth**

RB (Baptist Health System Inc) Series 2005A	5.00%	11/15/09	1,565	1,567
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Health Care Auth for Baptist Health

Bonds Series 2006D	5.00%	11/15/11	1,600	1,642
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Mobile IDB

Pollution Control Refunding RB (International Paper Co) Series 1994A	4.65%	12/01/11	600	605
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3,814**ARIZONA 0.2%****Pinal Cnty**

COP Series 2004	4.00%	12/01/07	1,150	1,149
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ARKANSAS 0.8%**Fort Smith**

Sales and Use Tax Refunding and Improvement Bonds Series 2006	4.00%	09/01/14 (a)	3,310	3,328
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Sales and Use Tax Refunding and Improvement Bonds Series 2006	3.95%	09/01/15 (a)	2,035	2,031
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5,359**CALIFORNIA 0.3%****California**

Various Purpose GO Bonds	8.00%	11/01/07 (a)	750	755
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Imperial Redevelopment Agency

Subordinate Tax Allocation Notes Series 2006	4.50%	12/01/11	1,300	1,288
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2,043

Portfolio Holdings continued

Issuer Project Type of Security, Series	Rate	Maturity Date	Face Amount (\$ x 1,000)	Value (\$ x 1,000)
COLORADO 1.3%				
E-470 Public Highway Auth				
Sr RB Series 1997A	5.25%	09/01/07 (a)	8,245	8,327
DISTRICT OF COLUMBIA 0.1%				
District of Columbia HFA				
Capital Program RB (Housing Auth Modernization) Series 2005	5.00%	07/01/08 (a)	1,000	1,011
FLORIDA 3.9%				
Citizens Property Insurance Corp				
High-Risk Account Sr Secured Refunding Bonds Series 2007A	5.00%	03/01/10 (a)	5,000	5,140
East Homestead Community Development District				
Special Assessment RB Series 2006B	5.00%	05/01/11	720	709
Florida Hurricane Catastrophe Fund Finance Corp				
RB Series 2006A	5.00%	07/01/09	5,000	5,112
Highlands Cnty Health Facilities Auth				
Hospital RB (Adventist Health System/Sunbelt Obligated Group) Series 2005I	5.00%	11/16/09	8,150	8,306
Hospital Refunding RB (Adventist Health System/Sunbelt Obligated Group) Series 2005A	5.00%	11/15/07	525	526
Hospital Refunding RB (Adventist Health System/Sunbelt Obligated Group) Series 2005A	5.00%	11/15/09	250	254
Hospital Refunding RB (Adventist Health System/Sunbelt Obligated Group) Series 2005B	5.00%	11/15/07	900	902
Hospital Refunding RB (Adventist Health System/Sunbelt Obligated Group) Series 2005B	5.00%	11/15/09	500	508
Orlando				
Capital Improvement Special RB Series 2005B	5.00%	04/01/08	2,460	2,478
University of Florida Athletic Assn				
RB Series 2005	3.30%	10/01/08 (a)	1,500	<u>1,487</u>
				25,422
ILLINOIS 0.3%				
Illinois Education Facilities Auth				
RB (Univ of Chicago) Series 1998B	4.05%	07/01/09	2,000	2,009
INDIANA 0.7%				
Indiana Health & Educational Facility Financing Auth				
Hospital Refunding RB (Clarion Health Obligated Group) Series 2006B	5.00%	02/15/08	725	729
Hospital Refunding RB (Clarion Health Obligated Group) Series 2006B	5.00%	02/15/09	720	731
Seymour				
Economic Development Refunding RB (Union Camp Corp) Series 1992	6.25%	07/01/12	2,670	<u>2,845</u>
				4,305
IOWA 0.2%				
Iowa Finance Auth				
Health Facilities Development Refunding RB (Care Initiatives) Series 2006A	5.25%	07/01/10	1,450	1,471

Portfolio Holdings continued

Issuer Project Type of Security, Series	Rate	Maturity Date	Face Amount (\$ x 1,000)	Value (\$ x 1,000)
KENTUCKY 1.1%				
Kentucky Rural Water Finance Corp				
Public Projects Construction Notes Series A1	3.70%	10/15/07	7,225	7,224
LOUISIANA 0.9%				
Louisiana				
GO Match Bonds Series 2006B	5.00%	07/15/11 (a)	2,000	2,090
GO Refunding Bonds Series 1998A	5.25%	04/15/09 (a)	4,000	<u>4,075</u>
				6,165
MASSACHUSETTS 0.7%				
Massachusetts				
GO Bonds Consolidated Loan Series 1992D	6.00%	05/01/08	2,275	2,308
Massachusetts Development Finance Agency				
RB (Linden Ponds) Series 2007A	5.00%	11/15/10	1,000	1,002
RB (Linden Ponds) Series 2007A	5.13%	11/15/12	1,150	<u>1,152</u>
				4,462
MICHIGAN 1.6%				
Detroit Sewage Disposal System				
Second Lien RB Series 2001D2	5.50%	01/01/12 (a)	5,000	5,325
Kent Hospital Finance Auth				
Refunding RB (Spectrum Health) Series 2005B	5.00%	07/15/11	5,000	<u>5,154</u>
				10,479
MINNESOTA 0.2%				
Minnesota Municipal Power Agency				
Electric RB Series 2005	3.50%	10/01/07	445	445
Electric RB Series 2005	3.50%	10/01/08	685	<u>682</u>
				1,127
MISSISSIPPI 0.1%				
Mississippi Hospital Equipment & Facilities Auth				
RB (Mississippi Baptist Health Systems) Series 2007A	5.00%	08/15/09	500	508
MISSOURI 1.5%				
Bi-State Development Agency of the Missouri-Illinois Metropolitan District				
Subordinate Mass Transit Sales Tax Appropriation Bonds (Metrolink Cross Cnty Extension) Series 2005A	3.95%	10/01/09 (a)	3,000	3,000
Kansas City International Airport				
General Improvement Refunding RB Series 2005H	5.00%	09/01/08	6,480	<u>6,555</u>
				9,555

Portfolio Holdings continued

Issuer Project Type of Security, Series	Rate	Maturity Date	Face Amount (\$ x 1,000)	Value (\$ x 1,000)
NEVADA 1.4%				
Clark Cnty Special Improvement Dist #121				
Subordinate Local Improvement Refunding Bonds (Southern Highlands) Series 2006B	4.35%	12/01/09	465	464
Subordinate Local Improvement Refunding Bonds (Southern Highlands) Series 2006B	4.50%	12/01/10	485	483
Subordinate Local Improvement Refunding Bonds (Southern Highlands) Series 2006B	4.60%	12/01/11	245	244
Henderson				
Health Facility RB (Catholic Healthcare West) Series 2005B	5.00%	07/01/08	3,000	3,026
Health Facility RB (Catholic HealthCare West) Series 2007B	4.00%	07/01/12	2,000	1,960
Henderson Local Improvement District # T-18				
Limited Obligation Improvement (Inspirada) Bonds	4.60%	09/01/11	2,025	1,975
North Las Vegas Special Improvement Dist # 60				
Subordinate Local Improvement Refunding Bonds (Aliante) Series 2006B	4.15%	12/01/08	630	626
Subordinate Local Improvement Refunding Bonds (Aliante) Series 2006B	4.35%	12/01/09	330	326
				9,104
NEW JERSEY 2.2%				
Camden				
BAN Series 2006B	4.50%	09/04/07	10,423	10,423
New Jersey Economic Development Auth				
School Facilities Construction Bonds Series 2005O	3.25%	03/01/08	1,100	1,096
Weehawken Township				
TAN	4.50%	10/11/07	3,000	3,002
				14,521
NEW MEXICO 0.7%				
Farmington				
Pollution Control Refunding RB (Southern California Edison) Series 2005A	3.55%	04/01/10 (a)	4,850	4,823
NEW YORK 8.7%				
Buffalo & Fort Erie Public Bridge Auth				
Toll Bridge System Refunding RB Bonds Series 2005	4.00%	07/01/10 (a)	5,000	5,000
Metropolitan Transportation Auth				
Commuter Facilities Service Contract Bonds Series 1997-3	7.38%	07/01/08	505	520
New York City				
GO Bonds Fiscal 1997A	6.25%	08/01/08	2,000	2,015
GO Bonds Fiscal 1997H	5.90%	08/01/09	1,960	1,980
New York City IDA				
Pilot RB (Yankee Stadium) Series 2006	3.48%	03/01/20 (a)	15,360	14,946
New York State Dormitory Auth				
Mortgage Hospital RB (New York and Presbyterian Hospital) Series 1998	4.75%	08/01/16 (a)	7,000	7,090
State University Educational Facilities RB Series 1990C	7.38%	05/15/10	1,280	1,349
Third General Resolution RB (State Univ Educational Facilities) Series 2002B	5.25%	05/15/12 (a)	5,000	5,326

Portfolio Holdings continued

Issuer Project Type of Security, Series	Rate	Maturity Date	Face Amount (\$ x 1,000)	Value (\$ x 1,000)
New York State Power Auth				
General Purpose Bonds Series W	6.50%	01/01/08	560	565
Patchogue-Medford Union Free SD				
TAN 2007-2008	4.50%	06/27/08	10,000	10,031
Troy IDA				
Civic Facility RB (Rensselaer Polytechnic Institute) Series 2002E	4.05%	09/01/11	8,000	<u>8,062</u>
				56,884
<hr/> NORTH CAROLINA 2.5% <hr/>				
Fayetteville				
Public Works Commission Revenue Notes Series 2005	3.55%	01/15/08 (a)	5,030	5,026
North Carolina Eastern Municipal Power Agency				
Power System Refunding RB Series 1993B	7.00%	01/01/08	11,230	<u>11,332</u>
				16,358
<hr/> NORTH DAKOTA 0.2% <hr/>				
Ward Cnty				
Health Care Facilities RB (Trinity Obligated Group) Series 2006	5.00%	07/01/09	465	469
Health Care Facilities RB (Trinity Obligated Group) Series 2006	5.00%	07/01/11	1,000	<u>1,017</u>
				1,486
<hr/> OHIO 1.9% <hr/>				
American Municipal Power-Ohio				
Electricity Purchase RB (2007A Prepayment)	5.00%	02/01/11	10,000	10,241
Cleveland				
COP (Cleveland Stadium) Series 1997	5.25%	11/15/10 (a)	2,500	<u>2,557</u>
				12,798
<hr/> OREGON 0.1% <hr/>				
Forest Grove				
Student Housing RB (Oak Tree Foundation) Series 2007	5.00%	03/01/14 (d)	465	459
<hr/> PENNSYLVANIA 1.9% <hr/>				
Harrisburg Auth				
Refunding RB Series 1998A	5.00%	09/01/21 (a)	7,055	7,172
Southcentral General Auth				
Guaranteed RB Series 2001	4.50%	12/01/08 (a)	5,000	<u>5,049</u>
				12,221
<hr/> PUERTO RICO 2.4% <hr/>				
Government Development Bank of Puerto Rico				
CP Program	4.65%	09/04/07	5,700	5,700
CP Program	4.70%	09/06/07	3,000	3,000
CP Program	4.60%	09/10/07	2,476	2,476
CP Program	4.70%	09/14/07	4,250	<u>4,250</u>
				15,426

Portfolio Holdings continued

Issuer Project Type of Security, Series	Rate	Maturity Date	Face Amount (\$ x 1,000)	Value (\$ x 1,000)
SOUTH CAROLINA 0.8%				
Richland Cnty				
Environmental Improvement Refunding RB (International Paper Co) Series 2002A	4.25%	10/01/07	5,000	5,000
TENNESSEE 0.8%				
Tennessee Energy Acquisition Corp				
Gas Project RB Series 2006A	5.00%	09/01/09	5,000	5,078
TEXAS 4.2%				
Brazos River Auth				
Refunding RB (Houston Industries) Series 1998A	5.13%	05/01/19 (a)	1,750	1,793
Corpus Christi Independent SD				
Unlimited Tax Refunding Bonds Series 2005	5.00%	08/15/12 (a)	2,110	2,115
Harris Cnty Health Facilities Development Corp				
Hospital RB (Memorial Hermann Hospital System) Series 1998	5.25%	06/01/27 (a)	2,200	2,239
North East Independent SD				
Unlimited Tax School Building Bonds Series 2007A	0.00%	08/01/09 (a)	1,500	1,393
North Texas Tollway Auth				
Dallas North Tollway System Refunding RB Series 2003B	5.00%	07/01/08 (a)	3,000	3,030
Northside Independent SD				
Unlimited Tax School Building Bonds Series 2007A	3.78%	06/01/09 (a)(b)	10,000	10,010
Spring Independent SD				
Unlimited Tax Schoolhouse Bonds Series 2005A	5.00%	08/15/08 (a)(b)	5,000	5,060
Tarrant Cnty Cultural Education Facilities Finance Corp				
RB (Buckner Retirement Services) Series 2007	5.00%	11/15/08	745	755
Tomball Hospital Auth				
Refunding RB Series 2005	5.00%	07/01/09	1,205	<u>1,210</u>
				27,605
VIRGINIA 0.6%				
Louisa IDA				
Pollution Control RB (Virginia Electric & Power Co) Series 1984	3.84%	12/08/08	4,000	4,000
WASHINGTON 2.1%				
Energy Northwest				
Electric Refunding RB (Project 1) Series 2006A	5.00%	07/01/11	5,000	5,228
King Cnty				
Limited Tax GO Bonds (Baseball Stadium) Series 1997D	5.60%	12/01/09	6,710	6,873
Washington Higher Education Facilities Auth				
Refunding RB (Univ of Puget Sound) Series 2006A	5.00%	04/01/08 (a)	2,000	<u>2,014</u>
				14,115
Total Fixed-Rate Obligations (Cost \$295,180)				<u>294,308</u>

Portfolio Holdings continued

Issuer Project Type of Security, Series	Rate	Maturity Date	Face Amount (\$ x 1,000)	Value (\$ x 1,000)
Variable-Rate Obligations 54.0% of net assets				
ARIZONA 4.6%				
Arizona Educational Loan Marketing Corp				
RB Series 1998B	3.95%	09/13/07	600	600
Arizona Health Facilities Auth				
Hospital RB (Phoenix Children's Hospital) Series 2007A	4.95%	09/06/07	20,500	20,461
Maricopa Cnty IDA				
M/F Housing RB (AHF Affordable Housing Portfolio) Series 2003B	3.99%	09/06/07	6,755	6,755
Yavapai Cnty IDA				
Hospital RB (Yavapai Regional Medical Center) Series 2005	3.75%	09/04/07 (a)	2,000	<u>2,000</u>
				29,816
CALIFORNIA 1.3%				
Association of Bay Area Governments				
Refunding RB (Eskaton Properties) Series 2005	6.50%	09/05/07 (a)	1,000	1,000
California Statewide Communities Development Auth				
COP (Eskaton Properties Obligated Group)	5.00%	09/13/07 (a)	7,850	<u>7,850</u>
				8,850
FLORIDA 4.3%				
Alachua Cnty Health Facilities Auth				
Refunding RB (Shands HealthCare) Series 2007B	4.46%	09/01/07	10,210	9,704
Capital Trust Agency				
RB (Atlantic Housing Foundation Properties) Sr Series 2005A	4.10%	09/05/07	7,400	7,400
Gulf Breeze				
Capital Funding RB Series 1997A	2.14%	09/04/07 (a)	5,095	5,318
Orange Cnty Health Facilities Auth				
Hospital RB (Orlando Regional Healthcare System) Series 1999A	5.10%	09/13/07 (a)	6,025	<u>6,025</u>
				28,447
GEORGIA 0.3%				
Burke Cnty Development Auth				
Pollution Control RB (Georgia Power Co Plant Vogtle) First Series 1996	4.40%	10/03/07	2,300	2,300
ILLINOIS 0.2%				
Illinois Development Finance Auth				
RB (Resurrection Health Care) Series 2005D	4.70%	09/06/07	1,000	1,000
LOUISIANA 2.1%				
Louisiana Public Facilities Auth				
Equipment and Capital Facilities RB (Pooled Loan) Series 2002A	4.20%	09/06/07 (a)	10,810	10,810
RB (Blood Center Properties) Series 2000	4.22%	09/06/07 (a)	2,700	<u>2,700</u>
				13,510

Portfolio Holdings continued

Issuer Project Type of Security, Series	Rate	Maturity Date	Face Amount (\$ x 1,000)	Value (\$ x 1,000)
MASSACHUSETTS 6.2%				
Massachusetts				
GO Refunding Bonds Series 2006C	3.58%	09/01/07 (a)	10,395	9,857
GO Refunding Bonds Series 2007A	4.14%	11/01/07	25,000	24,616
Massachusetts Health & Educational Facilities Auth				
RB (New England Medical Center Hospitals) Series G2	3.95%	01/02/08 (a)	6,000	6,000
				40,473
MICHIGAN 1.7%				
Detroit Sewage Disposal System				
Sr Lien Refunding RB Series 2006D	4.19%	10/01/07 (a)	4,890	4,838
Michigan Strategic Fund				
Limited Obligation Refunding RB (Dow Chemical Co) Series 2003B1	4.22%	09/05/07	6,100	6,100
				10,938
NEBRASKA 1.7%				
Central Plains Energy Project				
Gas Project RB (Project 1) Series 2007B	4.24%	09/01/07	10,000	9,411
Gas Project RB (Project 1) Series 2007B	3.90%	09/04/07	2,000	1,960
				11,371
NEW JERSEY 3.7%				
New Jersey Economic Development Auth				
Cigarette Tax RB Series 2004	4.35%	09/06/07 (b)(c)	4,795	4,795
School Facilities Construction Bonds Series 2005O	4.15%	09/06/07 (b)(c)	9,995	9,995
School Facilities Construction Bonds Series 2006R3	3.82%	09/04/07 (a)	1,500	1,500
New Jersey Health Care Facilities Financing Auth				
RB (Catholic Health East) Series 2007E	4.52%	11/15/07	8,000	7,634
				23,924
NEW YORK 2.3%				
Metropolitan Transportation Auth				
Transportation RB Series 2006A	4.12%	09/06/07 (b)(c)	6,250	6,250
Transportation Refunding RB Series 2002A	4.12%	09/06/07 (b)(c)	2,595	2,595
New York City				
GO Bonds Fiscal 2006 Series I3	3.92%	09/04/07 (a)	4,700	4,700
GO Bonds Fiscal 2006 Series J	4.06%	09/06/07 (b)(c)	525	525
New York City Transitional Finance Auth				
Recovery Bonds Fiscal 2003 Series 2A	3.90%	09/04/07 (b)	990	990
				15,060
OHIO 0.8%				
Ohio Air Quality Development Auth				
Refunding RB (Cincinnati Gas & Electric Co) Series 1995A	4.15%	09/05/07	5,100	5,100

Portfolio Holdings continued

Issuer Project Type of Security, Series	Rate	Maturity Date	Face Amount (\$ x 1,000)	Value (\$ x 1,000)
OKLAHOMA 1.2%				
Tulsa Cnty Industrial Auth				
M/F Housing RB (AHF Affordable Housing) Series 2003B	4.50%	09/13/07	8,000	8,000
PENNSYLVANIA 5.5%				
Allegheny Cnty Hospital Development Auth				
Univ of Pittsburgh Medical Center RB Series 2007A1	4.41%	11/01/07	5,000	4,935
Cumberland Cnty Municipal Auth				
RB (Diakon Lutheran Social Ministries) Series 2007B	6.25%	09/27/07 (a)	5,000	5,000
Lehigh Cnty General Purpose Auth				
Hospital RB (Saint Luke's Hospital of Bethlehem) Series 2007	4.64%	11/15/07	9,965	9,049
Sayre Health Care Facilities Auth				
RB (Guthrie Health) Series 2007	4.37%	09/01/07	8,500	8,138
Schuylkill Cnty IDA				
Resource Recovery Refunding RB (WPS Westwood Generation)	4.20%	09/05/07	8,975	<u>8,975</u>
				36,097
PUERTO RICO 0.8%				
Puerto Rico Sales Tax Financing Corp				
Sales Tax RB Series 2007A	4.10%	09/06/07 (b)(c)	5,197	5,197
SOUTH CAROLINA 1.5%				
South Carolina Jobs EDA				
Hospital Improvement RB (Palmetto Health) Series 2007	4.70%	09/06/07	10,000	10,000
TENNESSEE 2.9%				
Shelby Cnty Health, Education & Housing Facility Board				
RB (Baptist Memorial Health Care) Series 2004A	5.00%	10/01/08	19,000	19,213
TEXAS 11.1%				
Capital Area Housing Finance Corp				
M/F Housing RB (AHF Affordable Housing) Series 2003A	2.94%	09/06/07	12,715	12,715
Housing Options				
M/F Housing RB (AHF Affordable Housing) Series 2003A	4.40%	09/13/07	4,000	4,000
Texas Municipal Gas Acquisition & Supply Corp I				
Gas Supply RB Sr Lien Series 2006B	3.92%	09/15/07	14,815	14,572
Gas Supply RB Sr Lien Series 2006B	4.14%	09/15/07	2,000	1,917
Gas Supply RB Sr Lien Series 2006B	4.29%	09/15/07	15,000	14,214
Texas Municipal Gas Acquisition & Supply Corp II				
Gas Supply RB Series 2007B	4.50%	09/06/07	25,000	<u>25,000</u>
				72,418
WASHINGTON 1.8%				
Washington Health Care Facilities Auth				
RB (Overlake Hospital Medical Center) Series 2005C1	5.75%	09/19/07 (a)	8,325	8,325
RB Series 2000	6.75%	10/03/07 (a)	2,000	2,000

Portfolio Holdings continued

Issuer Project Type of Security, Series	Rate	Maturity Date	Face Amount (\$ x 1,000)	Value (\$ x 1,000)
Washington Public Power Supply System				
Refunding RB (Nuclear Project No.1) Series 1993A	3.90%	01/02/08 (a)	1,400	<u>1,400</u>
				11,725
WEST VIRGINIA 0.0%				
West Virginia State Hospital Fin Auth				
RB (Charleston Area Medical Center) Series 2002A	4.09%	09/06/07 (a)	125	<u>125</u>
Total Variable-Rate Obligations (Cost \$358,613)				<u>353,564</u>

End of Investments.

At 08/31/07, the tax basis cost of the fund's investments was \$653,782 and the unrealized appreciation and depreciation was \$247 and (\$6,157), respectively, with a net unrealized depreciation of (\$5,910).

- (a) Credit-enhanced security.
- (b) Liquidity-enhanced security.
- (c) Securities exempt from registration under Rule 144A of the Securities Act of 1933. These securities may be resold in transactions exempt from registrations, normally to qualified institutional buyers. At the period end, the value of these amounted to \$29,357 or 4.5% of net assets.
- (d) Illiquid and/or restricted security.

BAN – Bond anticipation note

COP – Certificate of participation

GO – General obligation

HFA – Housing finance agency

IDA – Industrial development authority

IDB – Industrial development board

RB – Revenue bond

TAN – Tax anticipation note

Statement of

Assets and Liabilities

As of August 31, 2007. All numbers are x 1,000 except NAV.

Assets

Investments, at value (cost \$653,793)	\$647,872
Cash	987
Receivables:	
Investments sold	3,065
Interest	6,235
Fund shares sold	757
Prepaid expenses	+ 3
Total assets	658,919

Liabilities

Payables:	
Investments bought	2,000
Investment adviser and administrator fees	42
Transfer agent and shareholder services fees	5
Fund shares redeemed	2,173
Due to brokers	403
Distributions to shareholders	22
Accrued expenses	+ 59
Total liabilities	4,704

Net Assets

Total assets	658,919
Total liabilities	- 4,704
Net assets	\$654,215

Net Assets by Source

Capital received from investors	661,557
Distributions in excess of net investment income	(2)
Net realized capital losses	(1,419)
Net unrealized capital losses	(5,921)

Net Asset Value (NAV)

Net Assets	÷	Shares Outstanding	=	NAV
\$654,215		66,262		\$9.87

Statement of

Operations

For September 1, 2006 through August 31, 2007. All numbers are x 1,000.

Investment Income

Interest	\$21,833
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Net Realized Gains and Losses

Net realized losses on investments	(591)
Net realized losses on futures contracts	+ (659)

Net realized losses	(1,250)
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Net Unrealized Gains and Losses

Net unrealized losses on investments	(5,213)
Net unrealized gains on futures contracts	+ 285

Net unrealized losses	(4,928)
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Expenses

Investment adviser and administrator fees	1,960
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Transfer agent and shareholder service fees:	
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Investor Shares ¹	57
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Select Shares	547
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Registration fees	168
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Portfolio accounting fees	48
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Shareholder reports	47
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Professional fees	39
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Custodian fees	24
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Trustees' fees	13
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Overdraft expense	2
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Other expenses	+ 5
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Total expenses	2,910
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Expense reduction by adviser and Schwab	- 95
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Custody credits	- 15
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Net expenses	2,800
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Increase in Net Assets from Operations

Total investment income	21,833
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Net expenses	- 2,800
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Net investment income	19,033
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Net realized losses	(1,250)
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Net unrealized losses	+ (4,928)
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Increase in net assets from operations	\$12,855
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¹ Effective on August 6, 2007, all outstanding Investor Shares were converted into Select Shares.

Statements of

Changes in Net Assets

For the current and prior report periods. All numbers are x 1,000.

Operations

	9/1/06-8/31/07	9/1/05-8/31/06
Net investment income	\$19,033	\$11,549
Net realized losses	(1,250)	(239)
Net unrealized losses	+ (4,928)	(4)
Increase in net assets from operations	12,855	11,306

Distributions to Shareholders¹**Distributions from net investment income**

Investor Shares	728	682
Select Shares	+ 18,289	10,853
Total distributions from net investment income	\$19,017	\$11,535

Transactions in Fund Shares¹

	9/1/06-8/31/07		9/1/05-8/31/06	
	SHARES	VALUE	SHARES	VALUE
Shares Sold				
Investor Shares	1,612	\$16,047	1,677	\$16,713
Select Shares	+ 75,266	774,721	45,102	449,155
Total shares sold	76,878	\$790,768	46,779	\$465,868
Shares Reinvested				
Investor Shares	57	\$571	55	\$544
Select Shares	+ 1,393	13,856	857	8,541
Total shares reinvested	1,450	\$14,427	912	\$9,085
Shares Redeemed				
Investor Shares	(4,074)	(\$40,680)	(2,322)	(\$23,139)
Select Shares	+ (59,428)	(616,692)	(40,513)	(403,524)
Total shares redeemed	(63,502)	(\$657,372)	(42,835)	(\$426,663)
Net transactions in fund shares	14,826	\$147,823	4,856	\$48,290

Shares Outstanding and Net Assets

	9/1/06-8/31/07		9/1/05-8/31/06	
	SHARES	NET ASSETS	SHARES	NET ASSETS
Beginning of period	51,436	\$512,554	46,580	\$464,493
Total increase	+ 14,826	141,661	4,856	48,061
End of period	66,262	\$654,215	51,436	\$512,554
Distributions in excess of net investment income		(\$2)		\$-

¹ Effective on August 6, 2007, all outstanding Investor Shares (2,576 shares valued at \$25,765) were converted into Select Shares.

Schwab Tax-Free Bond FundTM

Financial Statements

Financial Highlights

	9/1/06- 8/31/07	9/1/05- 8/31/06	9/1/04- 8/31/05	9/1/03- 8/31/04	9/1/02- 8/31/03
Per Share Data (\$)					
Net asset value at beginning of period	11.10	11.25	11.33	11.04	11.05
Income from investment operations:					
Net investment income	0.44	0.44	0.45	0.45	0.45
Net realized and unrealized gains or losses	(0.35)	(0.15)	(0.08)	0.29	(0.01)
Total income from investment operations	0.09	0.29	0.37	0.74	0.44
Less distributions:					
Distributions from net investment income	(0.44)	(0.44)	(0.45)	(0.45)	(0.45)
Net asset value at end of period	10.75	11.10	11.25	11.33	11.04
Total return (%)	0.82	2.70	3.29	6.77	4.01
Ratios/Supplemental Data (%)					
Ratios to average net assets:					
Net operating expenses	0.59	0.65	0.65	0.65	0.62
Gross operating expenses	0.70	0.69	0.66	0.66	0.65
Net investment income	4.03	4.01	3.98	4.00	4.06
Portfolio turnover rate	29	23	1	10	22
Net assets, end of period (\$ x 1,000,000)	93	92	93	83	81

Portfolio Holdings as of August 31, 2007

This section shows all the securities in the fund's portfolio and their value as of the report date.

The fund files its complete schedule of portfolio holdings with the SEC for the first and third quarters of each fiscal year on Form N-Q. The fund's Form N-Q is available on the SEC's website at <http://www.sec.gov> and may be viewed and copied at the SEC's Public Reference Room in Washington, D.C. Call 1-800-SEC-0330 for information on the operation of the Public Reference Room. The schedule of portfolio holdings filed on a fund's most recent Form N-Q is also available by visiting Schwab's website at www.schwab.com/schwabfunds.

For fixed rate obligations, the rate shown is the interest rate (the rate established when the obligation was issued) and the maturity date shown is the stated legal maturity. For variable-rate obligations, the rate shown is the rate as of the report date, and the maturity date shown is the next interest rate change date.

Holdings by Category	Cost (\$ x 1,000)	Value (\$ x 1,000)
91.7% Fixed-Rate Obligations	85,623	85,603
6.6% Variable-Rate Obligations	6,195	6,198
98.3% Total Investments	91,818	91,801
1.7% Other Assets and Liabilities		1,552
100.0% Net Assets		93,353

Issuer Project Type of Security, Series	Rate	Maturity Date	Face Amount (\$ x 1,000)	Value (\$ x 1,000)
Fixed-Rate Obligations 91.7% of net assets				

CALIFORNIA 8.5%**California**

GO Refunding Bonds	4.50%	08/01/30	2,000	1,872
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Los Angeles Municipal Improvement Corp

Lease RB (Police Headquarters Facilities) Series 2006A	4.75%	01/01/31 (a)	2,000	1,964
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Oak Valley Hospital District

GO Bonds (Election of 2004) Series 2005	5.00%	07/01/29 (a)	2,065	2,105
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State Public Works Board

Lease Refunding RB (Dept of Health Services-Richmond Laboratory) Series 2005K	5.00%	11/01/24	2,000	<u>2,027</u>
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7,968**COLORADO 4.5%****Colorado Dept of Transportation**

RAN Series 2002B	5.50%	06/15/15 (a)	2,000	2,213
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Denver Convention Center Hotel Auth

Sr Refunding RB Series 2006	5.00%	12/01/30 (a)	2,000	<u>2,019</u>
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4,232**DISTRICT OF COLUMBIA 2.3%****District of Columbia**

COP Series 2003	5.50%	01/01/17 (a)	2,000	2,153
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GEORGIA 1.3%**Fulton Cnty Development Auth**

RB (Tuff Morehouse) Series 2002A	5.50%	02/01/22 (a)	1,180	1,248
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Portfolio Holdings continued

Issuer Project Type of Security, Series	Rate	Maturity Date	Face Amount (\$ x 1,000)	Value (\$ x 1,000)
ILLINOIS 2.2%				
Chicago				
O'Hare International Airport General Airport Third Lien RB Series 2005A	5.00%	01/01/29 (a)	2,000	2,022
INDIANA 1.1%				
Marion Cnty Convention & Recreational Facilities Auth				
Excise Taxes Lease Refunding Sr RB Series 2001A	5.00%	06/01/21 (a)	1,000	1,023
KENTUCKY 1.1%				
Jefferson Cnty				
Health Facilities RB (University Medical Center) Series 1997	5.25%	07/01/22 (a)	1,000	1,011
LOUISIANA 2.2%				
Louisiana Citizens Property Insurance Corp				
Assessment RB Series 2006B	5.00%	06/01/23 (a)	2,000	2,048
MARYLAND 1.4%				
Baltimore				
Convention Center Hotel RB Sr Series 2006A	5.25%	09/01/23 (a)	1,000	1,060
Maryland Housing & Community Development Dept				
RB Series 1996A	5.88%	07/01/16	225	<u>227</u>
				1,287
MASSACHUSETTS 3.5%				
Massachusetts Bay Transportation Auth				
Sr Sales Tax Bonds Series 2005B	5.50%	07/01/23 (a)	2,000	2,222
Massachusetts Development Finance Agency				
RB (Linden Ponds Inc Facility) Series 2007A	5.25%	11/15/15	1,000	<u>1,003</u>
				3,225
MICHIGAN 5.3%				
Delta Cnty Economic Development Corp				
Environmental Improvement Refunding RB (MeadWestvaco-Escanaba Paper Co) Series 2002	6.25%	04/15/12	1,000	1,103
Detroit				
Water Supply System Refunding Sr Lien RB Series 2003C	5.25%	07/01/16 (a)	2,620	2,789
Wayne Cnty Community College				
Improvement Bonds Series 1999	5.50%	07/01/19 (a)	1,000	<u>1,036</u>
				4,928
NEVADA 8.0%				
Clark Cnty SD				
GO (Limited Tax) Refunding Bonds Series 2007A	5.00%	06/15/22 (a)	3,000	3,147
Nevada				
Highway Improvement (Motor Vehicle Fuel Tax) RB Series 2004	5.50%	12/01/18 (a)	2,000	2,174

Portfolio Holdings continued

Issuer Project Type of Security, Series	Rate	Maturity Date	Face Amount (\$ x 1,000)	Value (\$ x 1,000)
Nevada Dept of Business & Industry				
RB (Las Vegas Monorail) First Tier Series 2000	5.63%	01/01/32 (a)	2,000	<u>2,105</u>
				7,426
NEW JERSEY 1.6%				
Washington (Township) Board of Education				
Refunding School Bonds	5.25%	01/01/27 (a)	1,400	1,517
NEW YORK 6.0%				
Hudson Yards Infrastructure Corp				
Sr RB Fiscal 2007 Series A	5.00%	02/15/47 (a)	1,000	1,010
Metropolitan Transportation Auth				
Refunding RB Series 2002A	5.50%	11/15/18 (a)	2,000	2,140
New York City				
GO Bonds Fiscal 2002 Series G	5.75%	08/01/16	965	1,040
New York City Municipal Water Finance Auth				
Water & Sewer System RB Series A	4.50%	06/15/37	1,500	<u>1,398</u>
				5,588
NORTH CAROLINA 3.0%				
North Carolina Medical Care Commission				
Health System RB (Mission Health Combined Group) Series 2007	4.50%	10/01/26	3,000	2,804
OREGON 4.9%				
Columbia River Peoples Utility District				
Electric System Revenue Obligations Series 2000B	5.50%	12/01/10 (a)	1,180	1,245
Forest Grove				
Student Housing RB (Oak Tree Foundation) Series 2007	5.00%	03/01/14 (b)	1,000	987
Morrow Cnty SD				
GO Bonds Series 2001	5.63%	06/15/11 (a)	2,235	<u>2,388</u>
				4,620
PENNSYLVANIA 3.6%				
Philadelphia Hospital & Higher Educational Facilities Auth				
Hospital RB (Children's Hospital of Philadelphia) Series 2007A	4.50%	07/01/33	2,000	1,845
Seneca Valley Unified SD				
GO Refunding Bonds Series 1998AA	5.15%	02/15/20 (a)	1,500	<u>1,507</u>
				3,352
RHODE ISLAND 0.0%				
Rhode Island Housing & Mortgage Finance Corp				
Homeownership Opportunity Bonds Series 10A	6.50%	10/01/22	20	20
TEXAS 12.5%				
Austin Combined Utilities				
Refunding RB Series 1997	5.13%	11/15/16 (a)	3,000	3,006
Harris Cnty				
Permanent Improvement Refunding Bonds Series 2004A	5.00%	10/01/18	1,885	1,975

Portfolio Holdings continued

Issuer Project Type of Security, Series	Rate	Maturity Date	Face Amount (\$ x 1,000)	Value (\$ x 1,000)
Harris Cnty Hospital District				
Refunding RB Series 2000	6.00%	08/15/10 (a)	1,000	1,065
Houston Combined Utility System				
First Lien Refunding RB Series 2007A	5.00%	11/15/33 (a)	2,000	2,033
Texas Municipal Gas Acquisition & Supply Corp I				
Gas Supply RB Sr Lien Series 2006A	5.25%	12/15/26	2,000	2,022
Texas Public Finance Auth				
Refunding RB (Texas Southern University) Series 1998A1	4.75%	11/01/17 (a)	1,545	1,560
				11,661

VERMONT 3.7%**Vermont Education & Health Buildings Financing Agency**

Hospital RB (Fletcher Allen Health Care) Series 2000A	6.00%	12/01/23 (a)	2,000	2,139
Hospital RB (Fletcher Allen Health Care) Series 2007A	4.75%	12/01/36	1,500	1,316
				3,455

WASHINGTON 10.6%**Kent SD No.415**

Unlimited Tax GO Refunding Bonds Series 1993A	5.55%	12/01/11	500	534
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North Kitsap SD No.400

Unlimited Tax GO Refunding Bonds Series 2005	5.13%	12/01/18 (a)	1,850	1,965
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Ocean Shores

Water & Sewer RB Series 2001	5.50%	06/01/11 (a)	2,000	2,127
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Washington Health Care Facilities Auth

RB (Catholic Health Initiatives) Series A	6.00%	12/01/20 (a)	3,000	3,195
RB (Swedish Health System) Series 1998	5.13%	11/15/18 (a)	2,000	2,044
				9,865

WISCONSIN 4.4%**Wisconsin**

GO Bonds Series 2005D	5.00%	05/01/21	4,000	4,150
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**Total Fixed-Rate Obligations
(Cost \$85,623)****85,603****Variable-Rate Obligations** 6.6% of net assets**ARIZONA 1.1%****Arizona Health Facilities Auth**

Hospital RB (Phoenix Children's Hospital) Series 2007A	4.95%	09/06/07	1,060	1,058
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CALIFORNIA 3.5%**Dept of Water Resources**

Power Supply RB Series 2002B2	3.95%	09/04/07 (a)	3,300	3,300
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TENNESSEE 0.4%**Clarksville Public Build Auth**

Pooled Financing RB Series 2001	3.96%	09/04/07 (a)	340	340
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Portfolio Holdings continued

Issuer Project Type of Security, Series	Rate	Maturity Date	Face Amount (\$ x 1,000)	Value (\$ x 1,000)
WASHINGTON 1.6%				
Washington Health Care Facilities Auth				
RB (Overlake Hospital Medical Center) Series 2005C1	5.75%	09/19/07 (a)	1,500	<u>1,500</u>
Total Variable-Rate Obligations (Cost \$6,195)				<u>6,198</u>

End of Investments.

At 08/31/07, the tax basis cost of the fund's investments was \$91,775 and the unrealized appreciation and depreciation was \$1,586 and (\$1,560), respectively, with a net appreciation of \$26.

- (a) Credit-enhanced security.
(b) Illiquid and/or restricted security.

COP – Certificate of participation
GO – General obligation
RAN – Revenue anticipation note
RB – Revenue bond
SD – School district

Statement of

Assets and Liabilities

As of August 31, 2007. All numbers are x 1,000 except NAV.

Assets

Investments, at value (cost \$91,818)	\$91,801
Cash	674
Receivables:	
Interest	1,045
Fund shares sold	5
Prepaid expenses	+ 1
Total assets	93,526

Liabilities

Payables:	
Investment adviser and administrator fees	3
Transfer agent and shareholder services fees	1
Fund shares redeemed	132
Distribution to shareholders	1
Accrued expenses	+ 36
Total liabilities	173

Net Assets

Total assets	93,526
Total liabilities	- 173
Net assets	\$93,353

Net Assets by Source

Capital received from investors	93,911
Net investment income not yet distributed	41
Net realized capital losses	(582)
Net unrealized capital losses	(17)

Net Asset Value (NAV)

Net Assets	÷	Shares Outstanding	=	NAV
\$93,353		8,682		\$10.75

Statement of

Operations

For September 1, 2006 through August 31, 2007. All numbers are x 1,000.

Investment Income

Interest	\$4,323
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Net Realized Gains and Losses

Net realized gains on investments	402
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Net Unrealized Gains and Losses

Net unrealized losses on investments	(3,453)
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Expenses

Investment adviser and administrator fees	281
Transfer agent and shareholder service fees	234
Portfolio accounting fees	41
Registration fees	28
Professional fees	28
Shareholder reports	26
Trustees' fees	10
Custodian fees	3
Other expenses	+ 2
Total expenses	653
Expense reduction by adviser and Schwab	- 93
Custody credits	- 7
Net expenses	553

Increase in Net Assets from Operations

Total investment income	4,323
Net expenses	- 553
Net investment income	3,770
Net realized gains	402
Net unrealized losses	+ (3,453)
Increase in net assets from operations	\$719

Statements of

Changes in Net Assets

For the current and prior report periods. All numbers are x 1,000.

Operations

	9/1/06-8/31/07	9/1/05-8/31/06
Net investment income	\$3,770	\$3,705
Net realized gains	402	638
Net unrealized losses	+ (3,453)	(1,947)
Increase in net assets from operations	719	2,396

Distributions to Shareholders

Distributions from net investment income	\$3,768	\$3,703
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Transactions in Fund Shares

	9/1/06-8/31/07		9/1/05-8/31/06	
	SHARES	VALUE	SHARES	VALUE
Shares sold	2,361	\$25,991	2,417	\$26,801
Shares reinvested	225	2,484	238	2,626
Shares redeemed	+ (2,189)	(24,064)	(2,615)	(28,923)
Net transactions in fund shares	397	\$4,411	40	\$504

Shares Outstanding and Net Assets

	9/1/06-8/31/07		9/1/05-8/31/06	
	SHARES	NET ASSETS	SHARES	NET ASSETS
Beginning of period	8,285	\$91,991	8,245	\$92,794
Total increase or decrease	+ 397	1,362	40	(803)
End of period	8,682	\$93,353	8,285	\$91,991
Net investment income not yet distributed		\$41		\$145

Schwab California Tax-Free YieldPlus FundTM

Financial Statements

Financial Highlights

	9/1/06- 8/31/2007 ¹	9/1/05- 8/31/06	12/16/04 ² 8/31/05
Per Share Data (\$)			
Net asset value at beginning of period	9.98	9.95	10.00
Income from investment operations:			
Net investment income	0.32	0.27	0.15
Net realized and unrealized gains or losses	(0.11)	0.03	(0.05)
Total income from investment operations	0.21	0.30	0.10
Less distributions:			
Distributions from net investment income	(0.32)	(0.27)	(0.15)
Net asset value at end of period	9.87	9.98	9.95
Total return (%)	2.16	3.06	1.03 ³
Ratios/Supplemental Data (%)			
Ratios to average net assets:			
Net operating expenses	0.45	0.46	0.28 ⁴
Gross operating expenses	0.45	0.46	0.51 ⁴
Net investment income	3.26	2.74	2.21 ⁴
Portfolio turnover rate	38	70	52 ³
Net assets, end of period (\$ x 1,000,000)	1,053	768	516

¹ Effective on August 6, 2007, all outstanding Investor Shares were converted into Select Shares. The figures in the Financial Highlights reflect only the remaining share class.

² Commencement of operations.

³ Not annualized.

⁴ Annualized.

Portfolio Holdings as of August 31, 2007

This section shows all the securities in the fund's portfolio and their value as of the report date.

The fund files its complete schedule of portfolio holdings with the SEC for the first and third quarters of each fiscal year on Form N-Q. The fund's Form N-Q is available on the SEC's website at <http://www.sec.gov> and may be viewed and copied at the SEC's Public Reference Room in Washington, D.C. Call 1-800-SEC-0330 for information on the operation of the Public Reference Room. The schedule of portfolio holdings filed on a fund's most recent Form N-Q is also available by visiting Schwab's website at www.schwab.com/schwabfunds.

For fixed rate obligations, the rate shown is the interest rate (the rate established when the obligation was issued) and the maturity date shown is the stated legal maturity. For variable-rate obligations, the rate shown is the rate as of the report date, and the maturity date shown is the next interest rate change date.

Holdings by Category	Cost (\$ x 1,000)	Value (\$ x 1,000)
37.6% Fixed-Rate Obligations	395,656	396,522
60.2% Variable-Rate Obligations	644,773	633,496
97.8% Total Investments	1,040,429	1,030,018
2.2% Other Assets and Liabilities		23,278
100.0% Net Assets		1,053,296

Issuer				
Project				
Type of Security, Series	Rate	Maturity Date	Face Amount (\$ x 1,000)	Value (\$ x 1,000)
Fixed-Rate Obligations 37.6% of net assets				

CALIFORNIA 33.5%**Alameda Public Financing Auth**

RB (1997 RB Refinancing) Series 1999	4.95%	09/02/07	2,065	2,065
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Association of Bay Area Governments

RB (Georgiana Bruce Kirby Preparatory School) Series 2007	3.85%	02/01/12 (a)	4,000	4,000
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Bay Area Toll Auth

San Francisco Bay Area Toll Bridge RB Series 2006F	5.00%	04/01/09 (d)	5,815	5,940
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California

Economic Recovery Bonds Series 2004A	5.25%	07/01/13 (d)	52,415	56,405
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Federal Highway Grant Anticipation Bonds Series 2004A	5.00%	02/01/08 (a)(d)	1,360	1,368
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GO Refunding Bonds Series 2005	5.00%	05/01/12 (d)	7,065	7,433
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Various Purpose GO Bonds	6.60%	02/01/09	14,505	15,100
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Various Purpose GO Bonds	5.00%	10/01/13	6,200	6,590
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Various Purpose GO Bonds	5.25%	02/01/14	8,355	8,935
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Various Purpose GO Bonds	5.00%	03/01/14	11,300	11,993
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Various Purpose GO Bonds	5.00%	08/01/14	12,400	13,203
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California Dept of Water Resources

Power Supply RB Series 2002A	5.50%	05/01/08 (d)	12,720	12,872
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Power Supply RB Series 2002A	5.50%	05/01/09 (d)	2,000	2,059
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California Health Facilities Finance Auth

RB (Catholic Healthcare West) Series 2005G	5.00%	07/01/09 (d)	1,755	1,787
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RB (Catholic Healthcare West) Series 2005G	5.00%	07/01/10 (d)	2,000	2,045
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Refunding RB (Cedars-Sinai Medical Center) Series 2005	5.00%	11/15/08 (d)	1,000	1,015
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Refunding RB (Cedars-Sinai Medical Center) Series 2005	5.00%	11/15/10 (d)	2,035	2,094
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California Infrastructure and Economic Development Bank

RB (J. David Gladstone Institutes) Series 2001	4.00%	10/01/07 (d)	2,000	2,000
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Portfolio Holdings continued

Issuer Project Type of Security, Series	Rate	Maturity Date	Face Amount (\$ x 1,000)	Value (\$ x 1,000)
California Public Works Board				
Lease RB (Butterfield State Office Complex) Series 2005A	5.00%	06/01/08 (d)	4,515	4,559
Lease RB (Butterfield State Office Complex) Series 2005A	5.00%	06/01/09 (d)	1,940	1,984
Lease RB (Dept of Corrections) Series 2003C	5.00%	06/01/12 (d)	5,000	5,253
Lease Refunding RB (Dept of Corrections) Series 2004D	4.50%	12/01/07 (a)(d)	3,550	3,557
California State University Trustees				
Trustees Systemwide RB Series 2005C	4.00%	11/01/08 (d)	2,050	2,056
Trustees Systemwide RB Series 2005C	4.00%	11/01/09 (d)	3,015	3,032
California Statewide Communities Development Auth				
Pollution Control Refunding RB (Southern California Edison Co) Series A	4.10%	04/01/13 (a)(d)	2,000	2,022
RB (Daughters of Charity Health System) Series 2005F	5.00%	07/01/08 (d)	1,240	1,248
RB (Daughters of Charity Health System) Series 2005F	5.00%	07/01/09 (d)	3,065	3,109
RB (Daughters of Charity Health System) Series 2005F	5.00%	07/01/10 (d)	2,455	2,505
RB (Daughters of Charity Health System) Series 2005G	5.25%	07/01/11 (d)	895	926
RB (Huntington Memorial Hospital) Series 2005	5.00%	07/01/09 (d)	3,250	3,307
RB (Kaiser Permanente) Series 2002E	4.70%	06/01/09 (d)	5,355	5,405
Student Housing RB (CHF-Irvine LLC-East Campus Apts) Series 2004	5.50%	05/15/08	400	404
Student Housing RB (CHF-Irvine LLC-East Campus Apts) Series 2004	5.50%	05/15/09	660	669
Student Housing RB (CHF-Irvine LLC-East Campus Apts) Series 2004	5.50%	05/15/10 (d)	900	917
Student Housing RB (CHF-Irvine LLC-East Campus Apts) Series 2004	5.50%	05/15/11 (d)	1,160	1,185
Student Housing RB (CHF-Irvine LLC-East Campus Apts) Series 2004	5.50%	05/15/12 (d)	1,450	1,484
Chula Vista Public Financing Auth				
Refunding RB Series 2005A	4.00%	09/01/12 (a)(d)	2,980	3,031
Del Mar Race Track Auth				
RB Series 2005	5.00%	08/15/08	550	554
RB Series 2005	5.00%	08/15/09	500	506
RB Series 2005	5.00%	08/15/10	1,415	1,440
Golden State Tobacco Securitization Corp				
Enhanced Tobacco Settlement Asset-Backed Bonds Series 2003B	5.50%	06/01/13 (d)	16,675	18,096
Enhanced Tobacco Settlement Asset-Backed Bonds Series 2003B	5.63%	06/01/13 (d)	27,915	30,473
Enhanced Tobacco Settlement Asset-Backed Bonds Series 2005A	5.00%	06/01/17 (d)	5,500	5,517
Enhanced Tobacco Settlement Asset-Backed Bonds Series 2005A	5.00%	06/01/18 (d)	4,190	4,221
Enhanced Tobacco Settlement Asset-Backed Bonds Series 2005A	5.00%	06/01/19	11,920	12,078
Imperial Redevelopment Agency				
Subordinate Tax Allocation Notes Series 2006	4.50%	12/01/11 (d)	2,000	1,981
Indio Public Financing Authority				
Lease RB Series 2007B	3.80%	11/01/12 (a)(b)	5,000	5,007
Los Angeles				
TRAN Series 2007	4.50%	06/30/08	25,000	25,180
Los Angeles Cnty Metropolitan Transportation Auth				
Sales Tax RB (Prop C) Second Sr Series 2004A	5.00%	07/01/10 (a)(d)	3,390	3,514
Sales Tax Refunding RB (Prop C) Second Sr Series 1998A	5.50%	07/01/10 (a)(d)	2,485	2,609

Portfolio Holdings continued

Issuer Project Type of Security, Series	Rate	Maturity Date	Face Amount (\$ x 1,000)	Value (\$ x 1,000)
Los Angeles Cnty Public Works Financing Auth				
Lease Refunding RB (2005 Master Refunding) Series A	5.00%	12/01/08 (a)(d)	1,000	1,017
Los Angeles Community Redevelopment Agency				
Pooled Financing Refunding Bonds Series F	5.00%	09/01/07 (a)	810	810
Orange Cnty Public Financing Auth				
Lease Refunding RB Series 2005	5.00%	07/01/10 (a)(d)	7,155	7,417
Perris Public Financing Auth				
2006 Tax Allocation RB	4.40%	10/01/10 (d)	480	478
2006 Tax Allocation RB	4.55%	10/01/11 (d)	520	518
2006 Tax Allocation RB	4.65%	10/01/12 (d)	545	543
Rancho Cordova				
Special Tax Bonds Series 2007	4.50%	09/01/15	1,200	1,185
Redding Joint Powers Financing Auth				
Electric System RB Series 1996A	5.50%	06/01/11 (a)	2,000	2,022
Roseville Natural Gas Financing Auth				
RB Series 2007	4.00%	02/15/09 (d)	1,500	1,496
RB Series 2007	5.00%	02/15/11 (d)	1,000	1,024
Sacramento Municipal Utility District				
Electric Refunding RB Series 1997L	5.00%	07/01/11 (a)(d)	2,500	2,552
San Diego Cnty				
COP (Burnham Institute for Medical Research) Series 2006	5.00%	09/01/09 (d)	1,085	1,095
COP (Burnham Institute for Medical Research) Series 2006	5.00%	09/01/10 (d)	1,000	1,011
San Francisco State University				
Student Housing RB (Auxiliary Organization) Series 1999	5.00%	07/01/08	400	404
Santa Barbara Redevelopment Agency				
Tax Allocation Refunding Bonds (Central City Redevelopment) Sr Series 1995A	6.00%	03/01/08 (a)(d)	1,535	1,553
Santa Clara				
Insurance Funding Bonds Series 1987	3.00%	04/01/08 (a)(d)	5,000	4,983
Sonoma Cnty Junior College Dist				
GO Bonds (Election of 2002) Series B	3.83%	09/06/07 (a)(b)(c)	4,960	4,960
Western Placer Unified SD				
COP (School Facilities) Series 2006B	3.63%	12/01/09 (a)(b)(d)	6,000	5,981
				353,782
PUERTO RICO 4.1%				
Government Development Bank of Puerto Rico				
CP Program	4.65%	09/04/07	3,700	3,700
CP Program	4.70%	09/06/07	9,000	9,000
CP Program	4.60%	09/10/07	8,851	8,851
CP Program	4.70%	09/14/07	3,750	3,750
Puerto Rico				
Public Improvement Refunding Bonds Series 2003C	5.00%	07/01/08	4,800	4,842
Puerto Rico Public Buildings Auth				
Government Facilities RB Series B	5.00%	07/01/09 (a)	1,000	1,016
Government Facilities Refunding RB Series J	5.00%	07/01/12 (a)(d)	11,000	11,581
				42,740
Total Fixed-Rate Obligations (Cost \$395,656)				396,522

Portfolio Holdings continued

Issuer Project Type of Security, Series	Rate	Maturity Date	Face Amount (\$ x 1,000)	Value (\$ x 1,000)
Variable-Rate Obligations 60.2% of net assets				
CALIFORNIA 45.3%				
Association of Bay Area Governments				
Refunding RB (Casa De Las Campanas) Series 2007A	6.00%	09/06/07 (a)(b)	14,350	14,350
Refunding RB (Eskaton Properties) Series 2005	6.50%	09/06/07 (a)	1,000	1,000
California				
Economic Recovery Bonds Series 2004C5	3.79%	09/04/07 (b)	570	570
GO Refunding Bonds	4.11%	09/06/07 (b)(c)	13,285	13,285
GO Refunding Bonds Series 2007	4.03%	09/06/07 (a)(b)(c)	14,000	14,000
Various Purpose GO Bonds	3.98%	09/06/07 (a)(b)(c)	6,830	6,830
Various Purpose GO Bonds	4.11%	09/06/07 (b)(c)(d)	10,060	10,060
Various Purpose GO Bonds	4.11%	09/07/07 (b)(c)	26,290	26,290
California Dept of Water Resources				
Power Supply RB Series 2002B2	3.95%	09/04/07 (a)	1,550	1,550
Power Supply RB Series 2002C4	4.05%	09/06/07 (a)	1,000	1,000
Power Supply RB Series 2005F3	3.88%	09/04/07 (a)	800	800
California Statewide Communities Development Auth				
COP (Eskaton Properties Obligated Group)	5.00%	09/13/07 (a)	14,500	14,500
RB (Kaiser Permanente) Series 2007B	4.37%	10/01/07	42,000	37,814
RB (Redlands Community Hospital) Series 2005B	4.75%	09/06/07 (a)	2,350	2,350
RB (Sutter Health) Series 2003A	4.03%	09/06/07 (a)(b)(c)	3,645	3,645
Golden State Tobacco Securitization Corp				
Enhanced Tobacco Settlement Asset-Backed Bonds Series 2005A	3.99%	09/06/07 (a)(b)(c)	16,570	16,570
Tobacco Settlement Asset-Backed Bonds Series 2007A1	3.99%	09/06/07 (a)(b)(c)	8,000	8,000
Modesto Irrigation District Financing Auth				
Domestic Water Project RB Series 2007F	4.16%	09/04/07 (a)	11,685	11,545
Modesto Public Financing Auth				
Leasing Refunding and Capital Improvement Bonds	3.70%	09/03/08 (a)	24,675	24,675
Northern California Gas Auth No.1				
Gas Project RB Series 2007B	4.31%	10/01/07	50,000	46,470
Sacramento Cnty Sanitation District Financing Auth				
Refunding RB Series 2007B	4.12%	09/04/07 (a)	30,000	29,368
Sacramento Cnty Water Finance Auth				
RB Series 2007B	4.14%	09/03/07 (a)	50,000	49,206
Sacramento Finance Auth				
Refunding RB (Master Lease Program Facilities) Series 2006E	4.03%	09/06/07 (a)(b)(c)	11,070	11,070
San Diego Public Facilities Financing Auth				
Subordinate Sewer Revenue Notes Series 2007	3.99%	09/06/07 (a)(b)(c)	50,000	50,000
San Jose Redevelopment Agency				
Tax Allocation Bonds (Merged Area Redevelopment) Series 2006D	4.03%	09/06/07 (a)(b)(c)	10,000	10,000
Tax Allocation Bonds (Merged Area Redevelopment) Series 2006D	4.03%	09/06/07 (a)(b)(c)	6,000	6,000
San Mateo Community College Dist				
GO Bonds (Election of 2005) Series 2006B	4.03%	09/06/07 (b)(c)	16,132	16,132
Santa Clara Valley Transportation Auth				
Sales Tax RB (2000 Measure A) Series 2006F	3.60%	11/06/07 (a)	20,000	20,000
University of California				
General RB Series 2007J	3.98%	09/06/07 (a)(b)(c)	15,365	15,365

Portfolio Holdings continued

Issuer Project Type of Security, Series	Rate	Maturity Date	Face Amount (\$ x 1,000)	Value (\$ x 1,000)
Whittier				
Refunding RB (Whittier College) Series 2004	5.90%	09/06/07 (a)(b)	14,500	<u>14,500</u>
				476,945
PUERTO RICO 14.9%				
Puerto Rico				
Public Improvement & Refunding Bonds Series 2000	3.98%	09/06/07 (a)(b)(c)	1,135	1,135
Public Improvement Bonds Series 1996	3.75%	01/02/08 (a)	12,900	12,900
Public Improvement Bonds Series 2001A	3.97%	09/06/07 (a)(b)(c)(d)	1,235	1,235
Public Improvement Refunding Bonds Series 2002A	4.03%	09/06/07 (a)(b)(c)	4,000	4,000
Public Improvement Refunding Bonds Series 2006A	3.98%	09/06/07 (a)(b)(c)	100	100
Puerto Rico Aqueduct & Sewer Auth				
BAN Series 2007B	4.03%	09/06/07 (a)(b)(c)	7,000	7,000
Refunding Bonds Series 1995	3.75%	01/02/08 (a)	2,000	2,000
Puerto Rico Electric Power Auth				
Power Refunding RB Series UU	4.11%	10/01/07 (a)	5,000	4,901
Refunding RB Series UU	4.00%	09/02/07 (a)(b)(c)	13,760	13,760
Puerto Rico Highway & Transportation Auth				
Transportation Refunding RB Series N	4.12%	10/01/07 (a)	30,000	29,154
Transportation Refunding RB Series N	4.12%	10/01/07 (a)	38,250	37,119
Puerto Rico Public Buildings Auth				
Refunding RB Series L	4.00%	09/06/07 (a)(b)(c)	4,000	4,000
Puerto Rico Sales Tax Financing Corp				
Sales Tax RB Series 2007A	4.03%	09/06/07 (a)(b)(c)	4,500	4,500
Sales Tax RB Series 2007A	4.10%	09/06/07 (b)(c)	27,247	27,247
Sales Tax RB Series 2007A	4.15%	09/06/07 (b)(c)	7,500	<u>7,500</u>
				156,551
Total Variable-Rate Obligations (Cost \$644,773)				<u>633,496</u>

End of Investments.

At 08/31/07 the tax basis cost of the fund's investments was \$1,040,429 and the unrealized appreciation and depreciation were \$1,560 and (\$11,971), respectively, with a net unrealized depreciation of (\$10,411).

- (a) Credit-enhanced security.
- (b) Liquidity-enhanced security.
- (c) Securities exempt from registration under Rule 144A of the Securities Act of 1933. These securities may be resold in transactions exempt from registrations, normally to qualified institutional buyers. At the period end, the value of these amounted to \$282,684 or 26.8% of net assets.
- (d) All or a portion of this security is held as collateral for open futures contracts.

BAN – Bond anticipation note

COP – Certificate of participation

GO – General obligation

RB – Revenue bond

TRAN – Tax and revenue anticipation note

Portfolio Holdings continued

In addition, the fund held the following at 08/31/07. All numbers are x1,000 except number of open futures contracts.

	Number of Contracts	Contract Value	Unrealized Losses
Futures Contracts			
10 Years, Short, U.S. Treasury Note, expires 12/19/07	(50)	5,452	(12)
5 Years, Short, U.S. Treasury Note, expires 12/31/07	(570)	60,821	<u>(258)</u>
Net Unrealized Losses			(270)

Statement of

Assets and Liabilities

As of August 31, 2007. All numbers are x 1,000 except NAV.

Assets

Investments, at value (cost \$1,040,429)	\$1,030,018
Cash	217
Receivables:	
Investments sold	13,166
Interest	9,997
Fund shares sold	2,152
Due from brokers for futures	140
Prepaid expenses	+ 5
Total assets	1,055,695

Liabilities

Payables:	
Investment adviser and administrator fees	28
Transfer agent and shareholder services fees	9
Fund shares redeemed	2,295
Accrued expenses	+ 67
Total liabilities	2,399

Net Assets

Total assets	1,055,695
Total liabilities	- 2,399
Net assets	\$1,053,296

Net Assets by Source

Capital received from investors	1,067,108
Net realized capital losses	(3,131)
Net unrealized capital losses	(10,681)

Net Asset Value (NAV)

Net Assets	÷	Shares Outstanding	=	NAV
\$1,053,296		106,740		\$9.87

Statement of

Operations

For September 1, 2006 through August 31, 2007. All numbers are x 1,000.

Investment Income

Interest	\$36,521
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Net Realized Gains and Losses

Net realized losses on investments	(134)
Net realized losses on futures contracts	+ (2,081)

Net realized losses	(2,215)
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Net Unrealized Gains and Losses

Net unrealized losses on investments	(11,417)
Net unrealized gains on futures contracts	+ 248

Net unrealized losses	(11,169)
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Expenses

Investment adviser and administrator fees	3,205
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Transfer agent and shareholder service fees:	
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Investor Shares ¹	39
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Select Shares	969
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Portfolio accounting fees	61
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Professional fees	47
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Shareholder reports	45
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Registration fees	31
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Custodian fees	28
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Trustees' fees	15
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Overdraft expense	4
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Other expenses	+ 6
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Total expenses	4,450
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Custody credits	- 15
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Expense reduction by adviser and Schwab	- 5
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Net expenses	4,430
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Increase in Net Assets from Operations

Total investment income	36,521
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Net expenses	- 4,430
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Net investment income	32,091
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Net realized losses	(2,215)
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Net unrealized losses	+ (11,169)
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Increase in net assets from operations	\$18,707
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¹ Effective on August 6, 2007, all outstanding Investor Shares were converted into Select Shares.

Statements of

Changes in Net Assets

For the current and prior report periods. All numbers are x 1,000.

Operations

	9/1/06-8/31/07	9/1/05-8/31/06
Net investment income	\$32,091	\$15,729
Net realized losses	(2,215)	(379)
Net unrealized gains or losses	+ (11,169)	1,999
Increase in net assets from operations	18,707	17,349

Distributions to Shareholders¹**Distributions from Net Investment Income**

Investor Shares	490	413
Select Shares	+ 31,697	15,312
Total distributions from net investment income	\$32,187	\$15,725

Transactions in Fund Shares¹

	9/1/06-8/31/07		9/1/05-8/31/06	
	SHARES	VALUE	SHARES	VALUE
Shares Sold				
Investor Shares	1,532	\$15,276	1,073	\$10,694
Select Shares	+ 103,728	1,034,189	64,137	639,292
Total shares sold	105,260	\$1,049,465	65,210	\$649,986
Shares Reinvested				
Investor Shares	37	\$366	30	\$300
Select Shares	+ 2,529	25,185	1,236	12,321
Total shares reinvested	2,566	\$25,551	1,266	\$12,621
Shares Redeemed				
Investor Shares	(3,053)	(\$30,483)	(1,535)	(\$15,280)
Select Shares	+ (76,467)	(760,566)	(40,309)	(401,658)
Total shares redeemed	(79,520)	(\$791,049)	(41,844)	(\$416,938)
Net transactions in fund shares	28,306	\$283,967	24,632	\$245,669

Shares Outstanding and Net Assets

	9/1/06-8/31/07		9/1/05-8/31/06	
	SHARES	NET ASSETS	SHARES	NET ASSETS
Beginning of period	78,434	\$782,809	53,802	\$535,516
Total increase	+ 28,306	270,487	24,632	247,293
End of period	106,740	\$1,053,296	78,434	\$782,809
Net investment income not yet distributed		\$-		\$10

¹ Effective on August 6, 2007, all outstanding Investor Shares (2,000 shares valued at \$19,980) were converted into Select Shares.

Schwab California Tax-Free Bond FundTM

Financial Statements

Financial Highlights

	9/1/06- 8/31/07	9/1/05- 8/31/06	9/1/04- 8/31/05	9/1/03- 8/31/04	9/1/02- 8/31/03
Per-Share Data (\$)					
Net asset value at beginning of period	11.66	11.84	11.78	11.45	11.69
Income from investment operations:					
Net investment income	0.48	0.49	0.51	0.50	0.49
Net realized and unrealized gains or losses	(0.30)	(0.17)	0.10	0.33	(0.24)
Total income from investment operations	0.18	0.32	0.61	0.83	0.25
Less distributions:					
Distributions from net investment income	(0.48)	(0.49)	(0.50)	(0.50)	(0.49)
Distributions from net realized gains	(0.06)	(0.01)	(0.05)	—	—
Total Distributions	(0.54)	(0.50)	(0.55)	(0.50)	(0.49)
Net asset value at end of period	11.30	11.66	11.84	11.78	11.45
Total return (%)	1.57	2.78	5.24	7.36	2.14
Ratios/Supplemental Data (%)					
Ratios to average net assets:					
Net operating expenses	0.56	0.60	0.61	0.61	0.58
Gross operating expenses	0.61	0.60	0.61	0.61	0.60
Net investment income	4.15	4.19	4.27	4.30	4.16
Portfolio turnover rate	19	19	8	15	29
Net assets, end of period (\$ x 1,000,000)	217	205	199	180	194

Portfolio Holdings as of August 31, 2007

This section shows all the securities in the fund's portfolio and their value as of the report date.

The fund files its complete schedule of portfolio holdings with the SEC for the first and third quarters of each fiscal year on Form N-Q. The fund's Form N-Q is available on the SEC's website at <http://www.sec.gov> and may be viewed and copied at the SEC's Public Reference Room in Washington, D.C. Call 1-800-SEC-0330 for information on the operation of the Public Reference Room. The schedule of portfolio holdings filed on a fund's most recent Form N-Q is also available by visiting Schwab's website at www.schwab.com/schwabfunds.

For fixed rate obligations, the rate shown is the interest rate (the rate established when the obligation was issued) and the maturity date shown is the stated legal maturity. For variable-rate obligations, the rate shown is the rate as of the report date, and the maturity date shown is the next interest rate change date.

Holdings by Category	Cost (\$ x 1,000)	Value (\$ x 1,000)
89.8% Fixed-Rate Obligations	191,906	194,604
9.8% Variable-Rate Obligations	21,350	21,350
99.6% Total Investments	213,256	215,954
0.4% Other Assets and Liabilities		870
100.0% Net Assets		216,824

Issuer Project Type of Security, Series	Rate	Maturity Date	Face Amount (\$ x 1,000)	Value (\$ x 1,000)
Fixed-Rate Obligations 89.8% of net assets				

CALIFORNIA 89.8%**Alameda Cnty**

COP (Alameda Cnty Medical Center) Series 1998 5.38% 06/01/18 (a) 3,400 3,478

Alameda Corridor Transportation Auth

Sr Lien RB Series 1999A 5.13% 10/01/16 (a) 1,170 1,211

Anaheim Public Financing Auth

Sr Lease RB Series 1997A 6.00% 09/01/24 (a) 5,000 5,803

Association of Bay Area Governments

Revenue COP (Lytton Gardens) Series 1999 6.00% 02/15/30 (e) 3,000 3,059

Tax Allocation RB (California Redevelopment Agency Pool) Series 1997A6 5.25% 12/15/17 (a) 1,200 1,228

Bay Area Toll Auth

San Francisco Bay Area Toll Bridge RB Series 2006F 5.00% 04/01/31 2,000 2,045

Brea Olinda Unified SD

GO Bonds Series 1999A 5.60% 08/01/20 (a) 1,000 1,051

Burbank Public Finance Auth

RB 2003 Series A (Golden State Redevelopment) 5.25% 12/01/13 (a) 1,200 1,304

RB 2003 Series A (Golden State Redevelopment) 5.25% 12/01/13 (a) 920 1,000

RB 2003 Series A (Golden State Redevelopment) 5.25% 12/01/17 (a) 1,625 1,741

RB 2003 Series A (Golden State Redevelopment) 5.25% 12/01/18 (a) 1,255 1,338

California

Dept of Veterans Affairs Home Purchase RB Series 2002A 5.30% 12/01/21 (a) 5,000 5,187

GO Bonds 5.63% 05/01/10 455 482

GO Bonds Series 2000 5.63% 05/01/10 265 281

GO Bonds Series 2000 5.63% 05/01/18 50 52

GO Refunding Bonds 5.25% 08/01/32 (a) 2,000 2,179

GO Refunding Bonds Series 2000 5.63% 05/01/10 85 90

Prerefunded GO Bonds Series 2006 5.63% 05/01/10 145 154

Various Purpose GO Bonds 5.25% 11/01/17 3,000 3,196

Various Purpose GO Bonds 5.00% 03/01/31 7,440 7,481

Portfolio Holdings continued

Issuer Project Type of Security, Series	Rate	Maturity Date	Face Amount (\$ x 1,000)	Value (\$ x 1,000)
California Dept of Water Resources				
Power Supply RB Series 2002A	5.75%	05/01/12	3,000	3,301
California Educational Facilities Auth				
RB (California College of Arts and Crafts) Series 2001	5.75%	06/01/25	1,800	1,846
RB (Pepperdine Univ) Series 2000	5.75%	09/15/08 (a)	3,000	3,096
California Health Facilities Fin Auth				
Refunding RB (Cedars-Sinai Medical Center) Series 2005	5.00%	11/15/27	4,000	4,000
California Infrastructure & Economic Development Bank				
RB (The J. David Gladstone Institutes) Series 2001	5.50%	10/01/19	1,250	1,310
California Public Works Board				
Lease RB (Dept of Corrections) Series 2003	5.50%	06/01/17	6,970	7,466
California State Public Works Board				
Lease Refunding RB (Dept of Health Services-Richmond Laboratory) Series 2005K	5.00%	11/01/24	3,000	3,040
California Statewide Communities Development Auth				
Collateralized RB Series 2001A	7.00%	04/20/36 (a)	4,000	4,430
COP (Internext Group) Series 1999	5.38%	04/01/17	4,405	4,463
Insured Health Facility RB (Los Angeles Jewish Home for the Aging) Series 2003	5.25%	11/15/23	3,000	3,083
RB (Huntington Memorial Hospital) Series 2005	5.00%	07/01/18	6,190	6,306
Ceres Redevelopment Agency				
Tax Allocation Bonds (Ceres Redevelopment Area No 1) Series 2003	5.00%	11/01/33 (a)	3,200	3,259
Cloverdale Community Development Agency				
Tax Allocation Refunding Bonds (Cloverdale Redevelopment) Series 2006	5.00%	08/01/31 (a)	2,330	2,367
Tax Allocation Refunding Bonds (Cloverdale Redevelopment) Series 2006	5.00%	08/01/36 (a)	3,520	3,563
Colton Public Finance Auth				
Special Tax RB Series 1996	5.45%	09/01/19 (a)	3,020	3,052
Contra Costa Cnty Public Financing Auth				
Tax Allocation RB Series 2003A	5.63%	08/01/13	4,115	4,513
Tax Allocation RB Series 2003A	5.63%	08/01/33	885	895
East Bay Municipal Utility District				
Water System Subordinated RB Series 1998	5.25%	06/01/08	2,600	2,657
Escondido				
Revenue COP Series 2000A	6.00%	09/01/10 (a)	1,850	1,982
Fontana Redevelopment Agency				
Tax Allocation Refunding Bonds (Jurupa Hills Redevelopment) Series 1997A	5.50%	10/01/19	3,500	3,573
Foothill-Eastern Transportation Corridor Agency				
Toll Road Refunding RB Series 1999	5.13%	01/15/19 (a)	5,000	5,171
Golden State Tobacco Securitization Corp				
Enhanced Tobacco Settlement Asset-Backed Bonds Series 2005A	5.00%	06/01/19	2,500	2,533
Hollister Joint Power Financing Auth				
Wastewater RB (Refinancing & Improvement) Series 2006	5.00%	06/01/32 (a)	2,960	3,004
Huntington Beach				
Lease RB (Capital Improvement Financing) Series 2000A	5.50%	09/01/20 (a)	1,500	1,569
Inglewood Redevelopment Agency				
Tax Allocation Refunding Bonds (Merged Redevelopment) Series 1998A	5.25%	05/01/16 (a)	1,000	1,093
Los Angeles Community Redevelopment Agency				
Lease RB (Vermont Manchester Social Services) Series 2005	5.00%	09/01/17 (a)	2,310	2,418

Portfolio Holdings continued

Issuer Project Type of Security, Series	Rate	Maturity Date	Face Amount (\$ x 1,000)	Value (\$ x 1,000)
Los Angeles Dept of Water & Power				
Power System RB Series 2005A	5.00%	07/01/35 (a)	4,000	4,077
Water System RB Series 2006A2	5.00%	07/01/35 (a)	3,000	3,071
Los Angeles Municipal Improvement Corp				
Lease Revenue Capital Equipment Series A	5.00%	08/01/14 (a)	1,000	1,068
Los Angeles Unified SD				
Bonds (Election of 2005) Series C	5.00%	07/01/26 (a)	2,000	2,069
GO Bonds (Election of 2004) Series F	4.75%	07/01/27 (a)	4,000	4,005
Lynwood Public Financing Auth				
Lease Refunding RB (Public Capital Improvement) Series 2003	5.00%	09/01/18 (a)	1,000	1,040
Marina Joint Powers Financing Auth				
M/F Housing RB (Abrams B Apts Financing) Series 2006	3.90%	11/15/16 (a)	4,000	3,862
Oakland Joint Power Financing Auth				
Reassessment RB Series 1999	5.50%	09/02/24	990	1,025
Oakland Redevelopment Agency				
Subordinated Tax Allocation Bonds (Central District Redevelopment) Series 2003	5.50%	09/01/14 (a)	1,615	1,745
Oceanside Community Development Commission				
M/F Rental Housing Refunding RB (Vista Del Oro Apts) Series 2001A	4.45%	04/01/11 (a)	1,250	1,265
Perris Public Financing Auth				
Refunding RB Series 2007A	5.00%	09/01/24 (a)(d)	1,815	1,849
Rancho Cordova				
Special Tax Bonds Series 2007	5.00%	09/01/20	1,820	1,776
Sacramento Finance Auth				
Capital Improvement RB Series 1999	5.88%	12/01/09 (a)(e)	3,000	3,205
Lease RB (EPA Building) Series 1998A	5.25%	05/01/19 (a)	1,575	1,615
Tax Allocation RB Series 2005A	5.00%	12/01/34 (a)	2,615	2,657
San Diego Cnty				
COP (Burnham Institute for Medical Research) Series 2006	5.00%	09/01/34	5,000	4,578
San Diego Redevelopment Agency				
Subordinate Tax Allocation Bonds (Horton Plaza Redevelopment) Series 2000	5.80%	11/01/21	2,500	2,600
San Francisco Airports Commission				
Second Series Refunding RB (San Francisco International Airport) Series 30	5.00%	05/01/17 (a)	3,680	3,871
San Francisco Bay Area Rapid Transit				
Sales Tax RB Series 1999	5.50%	07/01/09 (a)	1,000	1,044
Sales Tax RB Series 1999	5.50%	07/01/09 (a)	2,500	2,609
San Francisco State University				
Student Housing RB (Auxiliary Organization) Series 1999	5.20%	07/01/09	1,150	1,191
San Luis Obispo Cnty Finance Auth				
RB (Lopez Dam Improvement) Series 2000A	5.38%	08/01/24 (a)	1,000	1,038
Santa Ana Unified SD				
GO Bonds (Election of 1999) Series 2000	5.70%	08/01/29 (a)(e)	6,000	6,297
Santa Clara Cnty Financing Auth				
Lease RB (VMC Facility) Series 1994A	7.75%	11/15/10 (a)	1,460	1,633
Santa Clara Redevelopment Agency				
Tax Allocation Refunding RB (Bayshore North)	7.00%	07/01/10 (a)	960	1,003
South Orange Cnty Public Financing Auth				
Special Tax RB Series 1999A	5.25%	08/15/18 (a)	3,095	3,201
Taft City Elementary SD				
GO Bonds Series 2001A	4.90%	08/01/20 (a)	1,080	1,116

Portfolio Holdings continued

Issuer Project Type of Security, Series	Rate	Maturity Date	Face Amount (\$ x 1,000)	Value (\$ x 1,000)
Truckee Public Financing Auth				
Lease RB Series 2000A	5.88%	11/01/08 (a)	1,490	1,558
Whittier				
RB (Presbyterian Intercommunity Hospital) Series 2002	5.60%	06/01/12	2,000	<u>2,186</u>
Total Fixed-Rate Obligations (Cost \$191,906)				<u>194,604</u>

Variable-Rate Obligations 9.8% of net assets

CALIFORNIA 8.4%**California**

Economic Recovery Bonds Series 2004C3 3.85% 09/04/07 (b) 200 200

California Dept of Water Resources

Power Supply RB Series 2005F5 3.95% 09/04/07 (a) 10,000 10,000

Power Supply RB Series 2002B2 3.95% 09/04/07 (a) 5,850 5,850

Irvine Ranch Water District

Consolidated Series 1995 GO of Improvement Districts No. 140, 240, 105, & 250 3.83% 09/04/07 (a) 300 300

Southern California Metropolitan Water District

Water RB Series 2000B3 3.85% 09/04/07 (b) 2,000 2,000

18,350

PUERTO RICO 1.4%**Puerto Rico Sales Tax Financing Corp**

Sales Tax RB Series 2007A 4.10% 09/06/07 (b)(c) 3,000 3,000

**Total Variable-Rate Obligations
(Cost \$21,350)**

21,350

End of Investments.

At 08/31/07, the tax basis cost of the fund's investment was \$213,139, and the unrealized appreciation and depreciation were \$4,773 and (\$1,958), respectively, with a net appreciation of \$2,815.

- (a) Credit-enhanced security.
- (b) Liquidity-enhanced security.
- (c) Securities exempt from registration under Rule 144A of the Securities Act of 1933. These securities may be resold in transactions exempt from registrations, normally to qualified institutional buyers. At the period end, the value of these amounted to \$3,000 or 1.4% of net assets.
- (d) Delayed-delivery security.
- (e) All or a portion of this security is held as collateral for delayed delivery security.

COP – Certificate of participation

GO – General obligation

RB – Revenue bond

Statement of

Assets and Liabilities

As of August 31, 2007. All numbers are x 1,000 except NAV.

Assets

Investments, at value (cost \$213,256)	\$215,954
Cash	167
Receivables:	
Investments sold	35
Interest	2,828
Fund shares sold	164
Prepaid expenses	+ 1
Total assets	\$219,149

Liabilities

Payables:	
Investments bought	1,864
Investment adviser and administrator fees	3
Transfer agent and shareholder services fees	4
Fund shares redeemed	411
Distributions to shareholders	1
Accrued expenses	+ 42
Total liabilities	2,325

Net Assets

Total assets	\$219,149
Total liabilities	- 2,325
Net assets	\$216,824

Net Assets by Source

Capital received from investors	214,460
Net investment income not yet distributed	115
Net realized capital losses	(449)
Net unrealized capital gains	2,698

Net Assets**Net Asset Value (NAV)**

Net Assets	÷	Shares Outstanding	=	NAV
\$216,824		19,182		\$11.30

Statement of

Operations

For September 1, 2006 through August 31, 2007. All numbers are x 1,000.

Investment Income

Interest	\$9,970
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Net Realized Gains and Losses

Net realized losses on investments	(538)
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Net Unrealized Gains and Losses

Net unrealized losses on investments	(5,031)
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Expenses

Investment adviser and administrator fees	635
Transfer agent and shareholder service fees	529
Portfolio accounting fees	45
Shareholder reports	35
Professional fees	30
Trustees' fees	11
Registration fees	4
Custodian fees	4
Other expenses	+ 2
Total expenses	1,295
Expense reduction by adviser and Schwab	- 92
Custody credit	- 12
Net expenses	1,191

Increase in Net Assets from Operations

Total investment income	9,970
Net expenses	- 1,191
Net investment income	8,779
Net realized losses	(538)
Net unrealized losses	+ (5,031)
Increase in net assets from operations	\$3,210

Statements of

Changes in Net Assets

For the current and prior report periods. All numbers are x 1,000.

Operations

	9/1/06-8/31/07	9/1/05-8/31/06
Net investment income	\$8,779	\$8,363
Net realized gains and losses	(538)	1,068
Net unrealized losses	+	(4,027)
Increase in net assets from operations	3,210	5,404

Distributions to Shareholders

Distributions from net investment income	8,774	8,343
Distributions from net realized gains	+	192
Total distributions	\$9,946	\$8,535

Transactions in Fund Shares

	9/1/06-8/31/07		9/1/05-8/31/06	
	SHARES	VALUE	SHARES	VALUE
Shares sold	5,359	\$61,918	4,022	\$46,808
Shares reinvested	513	5,933	459	5,335
Shares redeemed	+	(4,277)	(3,738)	(43,410)
Net transactions in fund shares	1,595	\$18,485	743	\$8,733

Shares Outstanding and Net Assets

	9/1/06-8/31/07		9/1/05-8/31/06	
	SHARES	NET ASSETS	SHARES	NET ASSETS
Beginning of period	17,587	\$205,075	16,844	\$199,473
Total increase	+	1,595	743	5,602
End of period	19,182	\$216,824	17,587	\$205,075
Net investment income not yet distributed		\$115		\$223

Financial Notes

1. Business Structure of the Funds

Each of the funds discussed in this report is a series of Schwab Investments (the “trust”), a no-load, open-end management investment company. The company is organized as a Massachusetts business trust and is registered under the Investment Company Act of 1940, as amended. The list below shows all the funds in the trust including the funds discussed in this report, which are highlighted:

Schwab Investments (organized October 26, 1990)	Schwab Total Bond Market Fund
Schwab Tax-Free YieldPlus Fund	Schwab GNMA Fund
Schwab Tax-Free Bond Fund	Schwab Inflation Protected Fund
Schwab California Tax-Free YieldPlus Fund	Schwab 1000 Index Fund
Schwab California Tax-Free Bond Fund	Schwab Global Real Estate Fund
Schwab YieldPlus Fund	
Schwab Short-Term Bond Market Fund	

Effective on August 6, 2007, the investment strategies of the Schwab Long-Term Tax-Free Bond Fund and the Schwab California Long-Term Tax-Free Bond Fund were changed to shorten the average maturity to between three and ten years, and the names of these two funds were changed to Schwab Tax-Free Bond Fund and Schwab California Tax-Free Bond Fund, respectively.

Prior to August 6, 2007, Schwab Tax-Free YieldPlus Fund and Schwab California Tax-Free YieldPlus Fund offered two share classes: Investor Shares and Select Shares®. Effective on August 6, 2007, all outstanding Investor Shares were converted into Select Shares and each fund no longer offers separate share classes. Immediately after and as a result of the conversion, each shareholder of the Investor Shares became an owner of Select Shares of the same fund. The Schwab Tax-Free Bond Fund and Schwab California Tax-Free Bond Fund each offer one share class.

Shares are bought and sold at net asset value, or NAV, which is the price for all outstanding shares. Each share has a par value of 1/1,000 of a cent, and the trustees may authorize the issuance of as many shares as necessary.

2. Significant Accounting Policies:

The following is a summary of the significant accounting policies the funds used in the preparation of financial statements. The accounting policies are in conformity with the accounting principles generally accepted in the United States of America.

(a) Security Valuation:

The funds value the securities in their portfolios every business day. The funds use the following policies to value various types of securities:

Bonds and notes: valued at halfway between the most recent bid and asked quotes or, if such quotes are unavailable, at prices for securities of comparable maturity, credit quality and type. Valuations for bonds and notes are provided by an independent bond-pricing service.

Securities for which no quoted value is available: valued at fair value, as determined in good faith by the fund’s investment adviser using guidelines adopted by the fund’s Board of Trustees. In the determination of a fair valuation the guidelines include, but are not limited to, the use of analytical data, business conditions, recent trades, general and/or specific market trends and any emergency or significant events that would have a material impact on the value of the security.

Futures: open contracts are valued at their settlement prices as of the close of their exchanges. When a fund closes out a futures position, it calculates the difference between the value of the position at the beginning and at the end, and records a realized gain or loss accordingly.

Short-term securities (60 days or less to maturity): valued at amortized cost.

(b) Portfolio Investments:

Futures Contract: The funds may invest in futures contracts. Futures contracts involve certain risks because they can be very sensitive to market movements.

One risk is that the price of a futures contract may not move in perfect correlation with the price of the underlying securities. Another risk is that, at certain times, it may be impossible for a fund to close out a position in a futures contract, due to a

Financial Notes (continued)

2. Significant Accounting Policies (continued):

difference in trading hours or to market conditions that may reduce the liquidity for a futures contract or its underlying securities.

Because futures carry inherent risks, a fund must give the broker a deposit of cash and/or securities (the “initial margin”) whenever it enters into the futures contract. The amount of the deposit may vary from one contract to another, but it is generally a percentage of the contract amount.

Futures are traded publicly on exchanges, and their market value changes daily. A fund records the change in market value of futures, and also the change in the amount of margin deposit required (“due to/from broker”).

Delayed-delivery: The funds may buy securities on a delayed-delivery basis. In these transactions, a fund agrees to buy a security for a stated price, with settlement generally occurring within two weeks. If the security’s value falls before settlement occurs, a fund could end up paying more for the security than its market value at the time of settlement. The funds have set aside sufficient securities as collateral for those securities bought on a delayed-delivery basis.

(c) Security Transactions:

Security transactions are recorded as of the date the order to buy or sell the security is executed. Realized gains and losses from security transactions are based on the identified costs of the securities involved.

(d) Investment Income:

Interest income is recorded as it accrues. If a fund buys a debt security at a discount (that is, for less than its face value) or a premium (more than face value), it amortizes the discount or premium from the current date up to maturity. The fund then increases (in the case of discounts) or reduces (in the case of premiums) the income it records from the security. If the security is callable (meaning that the issuer has the option to pay it off before its maturity date), then the fund amortizes the premium to the security’s call date and price, rather than the maturity date and price.

(e) Expenses:

Expenses that are specific to a fund or a class within the trust are charged directly to that fund or class. Expenses that are common to all funds within the trust generally are allocated among the funds in proportion to their average daily net assets.

For funds offering multiple share classes, realized and unrealized gains or losses and net investment income, other than class specific expenses, are allocated daily to each class in proportion to their average daily net assets.

(f) Distributions to Shareholders:

The funds declare dividends every day they are open for business. These dividends, which are equal to a fund’s net investment income for that day, are paid out to shareholders once a month. The funds may make distributions from any net realized capital gains once a year.

(g) Custody Credit:

Each fund has an arrangement with its custodian bank under which the fund receives a credit for its uninvested cash balance to offset its custody fees and accounting fees. The credit amounts (if any) are disclosed in the Statement of Operations as a reduction to the fund’s operating expenses.

(h) Accounting Estimates:

The accounting policies described in this report conform to accounting principles generally accepted in the United States of America. Notwithstanding this, shareholders should understand that in order to follow these principles, fund management has to make estimates and assumptions that affect the information reported in the financial statements. It’s possible that once the results are known, they may turn out to be different from these estimates.

Each fund maintains its own account for purposes of holding assets and accounting, and is considered a separate entity for tax purposes. Within its account, each fund also keeps certain assets in segregated accounts, as may be required by securities law.

Financial Notes (continued)

2. Significant Accounting Policies (continued):

(i) Federal Income Taxes:

The funds intend to meet federal income and excise tax requirements for regulated investment companies. Accordingly, the funds distribute substantially all of their net investment income and realized net capital gains (if any) to their respective shareholders each year. As long as a fund meets the tax requirements, it is not required to pay federal income tax.

(j) Indemnification:

Under the funds' organizational documents, the officers and trustees are indemnified against certain liability arising out of the performance of their duties to the funds. In addition, in the normal course of business the funds enter into contracts with their vendors and others that provide general indemnifications. The funds' maximum exposure under these arrangements is unknown as this would involve future claims that may be made against the funds. However, based on experience, the fund expect the risk of loss to be remote.

(k) New Accounting Standards:

Financial Accounting Standards Board Interpretation (FIN) No. 48—Accounting for Uncertainty in Income Taxes—an Interpretation of SFAS No. 109, was issued in July 2006 and is effective for fiscal years beginning after December 15, 2006. This Interpretation provides new requirements for the recognition, measurement, and disclosure in the financial statements of a tax position taken or expected to be taken in a tax return when there is uncertainty about whether that tax position will ultimately be sustained. A fund with a fiscal year ending August 31 will implement FIN 48 no later than February 29, 2008 and it will apply to all open tax years.

In September 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 157, "Fair Value Measurements" (SFAS No. 157). SFAS No. 157 defines fair value, establishes a framework for measuring fair value in accordance with generally accepted accounting principles and expands disclosure about fair value measurements. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007.

Management is currently evaluating the impact of adopting FIN 48 and SFAS No. 157 on the funds' financial statements.

3. Affiliates and Affiliated Transactions:

(All dollar amounts are x 1,000)

Charles Schwab Investment Management, Inc. (CSIM or the investment adviser), a wholly owned subsidiary of The Charles Schwab Corporation, serves as the funds' investment adviser and administrator pursuant to an Investment Advisory and Administration Agreement (Advisory Agreement) between it and the trust.

For its advisory and administrative services to each fund, the investment adviser is entitled to receive an annual fee payable monthly based on each funds' average daily net assets described as follows:

<u>Average daily net assets</u>	<u>Tax-Free YieldPlus Fund</u>	<u>Tax-Free Bond Fund</u>	<u>California Tax-Free YieldPlus Fund</u>	<u>California Tax-Free Bond Fund</u>
First \$500 million	0.35%	0.30%	0.35%	0.30%
Over \$500 million	0.30%	0.22%	0.30%	0.22%

Charles Schwab & Co., Inc. ("Schwab") is an affiliate of the investment adviser and is the trust's shareholder services agent and transfer agent.

For its transfer agent and shareholder services, Schwab is entitled to receive an annual fee payable monthly based on the funds' average daily net assets described as follows:

	<u>Tax-Free YieldPlus Fund</u>	<u>Tax-Free Bond Fund</u>	<u>California Tax-Free YieldPlus Fund</u>	<u>California Tax-Free Bond Fund</u>
Transfer Agent Fees	0.05%	0.05%	0.05%	0.05%
Shareholder Service Fees	0.05%	0.20%	0.05%	0.20%

Financial Notes (continued)

3. Affiliates and Affiliated Transactions (continued):

(All dollar amounts are x 1,000)

Prior to August 6, 2007, the Schwab Tax-Free YieldPlus Fund and Schwab California Tax-Free YieldPlus Fund each offered two share classes: Investor Shares and Select Shares. The Transfer Agent Fees and Shareholder Service Fees for Investor Share Class were 0.05% and 0.20%, respectively.

Although these agreements specify certain fees for these services, CSIM and Schwab have made additional agreements with the funds to limit the total expenses charged, excluding interest, taxes and certain non-routine expenses as follows so long as CSIM serves as the adviser to the Funds:

<u>Tax-Free YieldPlus Fund</u>	<u>Tax-Free Bond Fund</u>	<u>California Tax-Free YieldPlus Fund</u>	<u>California Tax-Free Bond Fund</u>
0.49%	0.49%	0.49%	0.49%

Prior to May 7, 2007, such expense limitation was 0.64% for the Investor Shares in both Tax-Free YieldPlus Fund and California Tax-Free YieldPlus Fund, and 0.65% for Tax-Free Bond Fund.

The funds may make direct transactions with certain other Schwab Funds when practical. When one fund is seeking to sell a security that another is seeking to buy, an interfund transaction can allow both funds to benefit by reducing transaction costs. This practice is limited to funds that share the same investment adviser, trustees and officers. As of August 31, 2007, the fund's total security transactions with other Schwab Funds were as follows:

Tax-Free YieldPlus Fund	\$416,050
Tax-Free Bond Fund	28,140
California Tax-Free YieldPlus Fund	1,048,378
California Tax-Free Bond Fund	77,028

Pursuant to an exemptive order issued by the SEC, the funds may enter into interfund borrowing and lending transactions within the Schwab Funds. All loans are for temporary or emergency purposes only. The interest rate charged on the loan is the average of the overnight repurchase agreement rate and the short-term bank loan rate. The interfund lending facility is subject to the oversight and periodic review of the Board of Trustees of the Schwab Funds. There was no interfund borrowing or lending activity for the Funds during the period.

Trustees

Trustees may include people who are officers and/or directors of the investment adviser or Schwab. Federal securities law limits the percentage of such "interested persons" who may serve on a trust's board, and the trust was in compliance with these limitations throughout the report period. The trust did not pay any of these persons for their service as trustees, but it did pay non-interested persons (independent trustees), as noted in each fund's Statement of Operations.

4. Borrowing from Banks:

The funds may borrow money from banks and custodians. The funds may obtain temporary bank loans through the trust to which they belong, to use for meeting shareholder redemptions or for extraordinary or emergency purposes. The Schwab Funds have custodian overdraft facilities and uncommitted line of credit arrangements of \$150 million and \$100 million with State Street Corporation, and Bank of America, N.A., respectively. The funds pay interest on the amounts they borrow at rates that are negotiated periodically. There were no borrowings from the line of credit for any funds during the period.

Financial Notes (continued)

5. Purchases and Sales of Investment Securities:

(All dollar amounts are x 1,000)

For the period ended August 31, 2007, purchases and sales of securities (excluding short-term obligations and securities sold short) were as follows:

	<u>Purchases of Securities</u>	<u>Sales/Maturities of Securities</u>
Tax-Free YieldPlus Fund	\$392,036	\$189,385
Tax-Free Bond Fund	27,768	26,406
California Tax-Free YieldPlus Fund	500,621	211,271
California Tax-Free Bond Fund	45,748	38,071

6. Federal Income Taxes:

(All dollar amounts are x 1,000)

As of August 31, 2007, the components of distributable earnings on a tax-basis were as follows:

	<u>Tax-Free YieldPlus Fund</u>	<u>Tax-Free Bond Fund</u>	<u>California Tax-Free YieldPlus Fund</u>	<u>California Tax-Free Bond Fund</u>
Undistributed tax-exempt income	\$15	\$1	—	—
Undistributed ordinary income	—	—	—	—
Undistributed long-term capital gains	—	—	—	—
Unrealized appreciation	\$247	\$1,586	\$1,560	\$4,773
Unrealized depreciation	\$(6,157)	\$(1,560)	\$(11,971)	\$(1,958)
Net unrealized appreciation/(depreciation)	\$(5,910)	\$26	\$(10,411)	\$2,815

Net investment income and realized capital gains and losses may differ for financial statement and tax purposes primarily due to differing treatments of paydown gains and losses and amortization of bond discounts and premiums.

Capital loss carry forwards may be used to offset future realized capital gains for federal income tax purposes. As of August 31, 2007, the following funds had capital loss carry forwards available to offset future net capital gains before the expiration date:

<u>Expires</u>	<u>Tax-Free YieldPlus Fund</u>	<u>Tax-Free Bond Fund</u>	<u>California Tax-Free YieldPlus Fund</u>	<u>California Tax-Free Bond Fund</u>
2008	—	—	—	—
2009	—	\$584	—	—
2010	—	—	—	—
2012	—	—	—	—
2013	—	—	—	—
2014	\$159	—	\$476	—
2015	669	—	1,630	—
Total	\$828	\$584	\$2,106	\$—

For tax purposes, realized net capital losses occurring after October 31 may be deferred and treated as occurring on the first day of the following fiscal year. As of August 31, 2007, the funds had aggregate deferred realized net capital losses as follows:

	<u>Tax-Free YieldPlus Fund</u>	<u>Tax-Free Bond Fund</u>	<u>California Tax-Free YieldPlus Fund</u>	<u>California Tax-Free Bond Fund</u>
Deferred capital losses	\$601	—	\$1,297	\$451
Capital losses utilized	—	\$454	—	—

Financial Notes (continued)

6. Federal Income Taxes (continued):

(All dollar amounts are x 1,000)

The tax-basis components of distributions paid during the current and prior fiscal years were:

	<u>Tax-Free YieldPlus Fund</u>	<u>Tax-Free Bond Fund</u>	<u>California Tax-Free YieldPlus Fund</u>	<u>California Tax-Free Bond Fund</u>
Current period distributions				
Tax-exempt income	\$19,014	\$3,768	\$32,187	\$8,775
Ordinary income	3	—	—	84
Long-term capital gains	—	—	—	1,087
Prior period distributions				
Tax-exempt income	\$11,535	\$3,703	\$15,725	\$8,343
Ordinary income	—	—	—	23
Long-term capital gains	—	—	—	169

Permanent book and tax basis differences may result in reclassifications between capital account and other accounts as required. The adjustments have no impact on net assets or the results of operations. As of August 31, 2007, the funds made the following reclassifications:

	<u>Tax-Free YieldPlus Fund</u>	<u>Tax-Free Bond Fund</u>	<u>California Tax-Free YieldPlus Fund</u>	<u>California Tax-Free Bond Fund</u>
Capital shares	\$1	—	—	—
Undistributed net investment income	\$(18)	\$(106)	\$86	\$(113)
Net realized capital gains and losses	\$17	\$106	\$(86)	\$113

Other Federal Tax Information:

(Unaudited)

The funds designate the following percentage of the distributions paid from net investment income as exempt-interest dividends for the fiscal year ended August 31, 2007.

	<u>Percentage</u>
Tax-Free YieldPlus Fund	100%
Tax-Free Bond Fund	100%
California Tax-Free YieldPlus Fund	100%
California Tax-Free Bond Fund	100%

Report of Independent Registered Public Accounting Firm

To the Board of Trustees and Shareholders of:

Schwab Tax-Free YieldPlus Fund

Schwab Tax-Free Bond Fund

Schwab California Tax-Free YieldPlus Fund

Schwab California Tax-Free Bond Fund

In our opinion, the accompanying statements of assets and liabilities, including the portfolio holdings, and the related statements of operations and of changes in net assets and the financial highlights present fairly, in all material respects, the financial position of Schwab Tax-Free YieldPlus Fund, Schwab Tax-Free Bond Fund, Schwab California Tax-Free YieldPlus Fund, and Schwab California Tax-Free Bond Fund (the “Funds”) at August 31, 2007, the results of each of their operations for the period then ended, and the changes in each of their net assets for each of the two years in the period then ended and the financial highlights for each of the periods presented, in conformity with accounting principles generally accepted in the United States of America. These financial statements and financial highlights (hereafter referred to as “financial statements”) are the responsibility of the Funds’ management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these financial statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits, which included confirmation of securities at August 31, 2007 by correspondence with the custodian and brokers, provide a reasonable basis for our opinion.

PricewaterhouseCoopers LLP

San Francisco, California

October 17, 2007

Investment Advisory Agreement Approval

The Investment Company Act of 1940 (the “1940 Act”) requires that initial approval of, as well as the continuation of, a fund’s investment advisory agreement must be specifically approved (1) by the vote of the trustees or by a vote of the shareholders of the fund, and (2) by the vote of a majority of the trustees who are not parties to the investment advisory agreement or “interested persons” of any party (the “Independent Trustees”), cast in person at a meeting called for the purpose of voting on such approval. In connection with such approvals, the fund’s trustees must request and evaluate, and the investment adviser is required to furnish, such information as may be reasonably necessary to evaluate the terms of the advisory agreement. In addition, the Securities and Exchange Commission (the “SEC”) takes the position that, as part of their fiduciary duties with respect to fund fees, fund boards are required to evaluate the material factors applicable to a decision to approve an investment advisory agreement.

Consistent with these responsibilities, the Board of Trustees (the “Board” or the “Trustees”, as appropriate) calls and holds one or more meetings each year that are dedicated, in whole or in part, to considering whether to renew the investment advisory agreement between Schwab Investments (the “Trust”) and CSIM (the “Agreement”) with respect to existing funds in the Trust, including the Schwab Tax-Free YieldPlus Fund, Schwab Tax-Free Bond Fund (formerly Schwab Long-Term Tax-Free Bond Fund), Schwab California Tax-Free YieldPlus Fund, and Schwab California Tax-Free Bond Fund (formerly California Long-Term Tax-Free Bond Fund), and to review certain other agreements pursuant to which CSIM provides investment advisory services to certain other registered investment companies. In preparation for the meeting(s), the Board requests and reviews a wide variety of materials provided by CSIM, including information about CSIM’s affiliates, personnel and operations. The Board also receives extensive data provided by third parties. This information is in addition to the detailed information about the funds that the Board reviews during the course of each year, including information that relates to fund operations and fund performance. The Independent Trustees receive advice from independent counsel to the Independent Trustees, including a memo regarding the responsibilities of trustees for the approval of investment advisory contracts. In addition, the Independent Trustees meet in executive session outside the presence of fund management and participate in question and answer sessions with representatives of CSIM.

The Board, including a majority of the Independent Trustees, considered information specifically relating to its consideration of the continuance of the Agreement at meetings held on May 2, 2007, and June 5, 2007, and approved the renewal of the Agreement for an additional one year term at the meeting held on June 5, 2007. The Board’s approval of the Agreement was based on consideration and evaluation of a

variety of specific factors discussed at these meetings and at prior meetings, including:

1. the nature, extent and quality of the services provided to the funds under the Agreement, including the resources of CSIM and its affiliates dedicated to the funds;
2. each fund’s investment performance and how it compared to that of certain other comparable mutual funds;
3. each fund’s expenses and how those expenses compared to those of certain other comparable mutual funds;
4. the profitability of CSIM and its affiliates, including Charles Schwab & Co., Inc. (“Schwab”), with respect to each fund, including both direct and indirect benefits accruing to CSIM and its affiliates; and
5. the extent to which economies of scale would be realized as the funds grow and whether fee levels in the Agreement reflect those economies of scale for the benefit of fund investors.

Nature, Extent and Quality of Services. The Board considered the nature, extent and quality of the services provided by CSIM to the funds and the resources of CSIM and its affiliates dedicated to the funds. In this regard, the Trustees evaluated, among other things, CSIM’s personnel, experience, track record and compliance program. The information considered by the Trustees included specific information concerning changes in the nature, extent and quality of services provided by CSIM since the Trustees had last considered approval of the Agreement. The Trustees also considered investments in CSIM’s mutual fund infrastructure and the fact that Schwab’s wide range of products, services, and channel alternatives such as free advice, investment and research tools, Internet access and an array of account features that benefit the funds and their shareholders. The Trustees also considered CSIM’s top three ranking in an independent survey regarding mutual fund client loyalty, Schwab’s excellent reputation as a full service brokerage firm and its overall financial condition. Finally, the Trustees considered that the vast majority of the funds’ shareholders are also brokerage clients of Schwab. Following such evaluation, the Board concluded, within the context of its full deliberations, that the nature, extent and quality of services provided by CSIM to the funds and the resources of CSIM and its affiliates dedicated to the funds supported renewal of the Agreement.

Fund Performance. The Board considered fund performance in determining whether to renew the Agreement. Specifically, the Trustees considered each fund’s performance relative to a peer group and peer category of other mutual funds and appropriate indices/benchmarks, in light of total return, yield, when applicable, and market trends. As part of this review, the Trustees considered the composition of the peer group and peer category, selection criteria and the reputation of the third party who prepared the peer group and peer category analysis. In evaluating the performance of each fund, the Trustees considered both risk and shareholder risk expectations for such fund and the appropriateness of the benchmark

used to compare the performance of each fund. The Trustees further considered the level of fund performance in the context of its review of fund expenses and adviser profitability discussed below. Following such evaluation the Board concluded, within the context of its full deliberations, that the performance of the funds supported renewal of the Agreement.

Fund Expenses. With respect to the funds' expenses, the Trustees considered the rate of compensation called for by the Agreement, and each fund's net operating expense ratio, in each case, in comparison to those of other comparable mutual funds, such peer groups and comparisons having been selected and calculated by an independent third party. The Trustees considered the effects of CSIM's and Schwab's historical practice of voluntarily waiving management and other fees to prevent total fund expenses from exceeding a specified cap. The Trustees also considered fees charged by CSIM to other mutual funds and to other types of accounts, such as wrap accounts and offshore funds, but, with respect to such other types of accounts, accorded less weight to such comparisons due to the different legal, regulatory, compliance and operating features of mutual funds as compared to these other types of accounts. Following such evaluation, the Board concluded, within the context of its full deliberations, that the expenses of the funds are reasonable and supported renewal of the Agreement.

Profitability. With regard to profitability, the Trustees considered the compensation flowing to CSIM and its affiliates, directly or indirectly. In this connection, the Trustees reviewed management's profitability analyses, together with certain commentary thereon from an independent accounting firm. The Trustees also considered any other benefits derived by CSIM from its relationship with the funds, such as whether, by virtue of its management of the funds, CSIM obtains investment information or other research resources that aid it in providing advisory services to other clients. The Trustees considered whether the varied levels of compensation and profitability under the Agreement and other service agreements were reasonable and justified in light of the quality

of all services rendered to each fund by CSIM and its affiliates. The Board also considered information relating to changes to CSIM's business operations and how these changes affected CSIM's profitability under the Agreement. Based on this evaluation, the Board concluded, within the context of its full deliberations, that the profitability of CSIM is reasonable and supported renewal of the Agreement.

Economies of Scale. The Trustees considered the existence of any economies of scale and whether those are passed along to a fund's shareholders through a graduated investment advisory fee schedule or other means, including any fee waivers by CSIM and its affiliates. In this regard, and consistent with their consideration of fund expenses, the Trustees considered that CSIM and Schwab have previously committed resources to minimize the effects on shareholders of diseconomies of scale during periods when fund assets were relatively small through their contractual expense waivers. For example, such diseconomies of scale may particularly affect newer funds or funds with investment strategies that are from time to time out of favor, but shareholders may benefit from the continued availability of such funds at subsidized expense levels. The Trustees also considered existing contractual investment advisory fee schedules that include lower fees at higher graduated asset levels. The Board also considered certain existing commitments by CSIM and Schwab that are designed to pass along potential economies of scale to fund shareholders. Based on this evaluation the Board concluded, within the context of its full deliberations, that the funds obtain reasonable benefit from economies of scale.

In the course of their deliberations, the Trustees did not identify any particular information or factor that was all-important or controlling. Based on the Trustees' deliberation and their evaluation of the information described above, the Board, including all of the Independent Trustees, unanimously approved the continuation of the Agreement and concluded that the compensation under the Agreement is fair and reasonable in light of such services and expenses and such other matters as the trustees have considered to be relevant in the exercise of their reasonable judgment.

Trustees and Officers

The tables below give information as of August 31, 2007, about the trustees and officers for Schwab Investments, which includes the funds covered in this report. The “Fund Complex” includes the Charles Schwab Family of Funds, Schwab Capital Trust, Schwab Investments, Schwab Annuity Portfolios, and Laudus Trust. As of August 31, 2007, the Fund Complex included 70 funds.

The address for all trustees and officers is 101 Montgomery Street, San Francisco, CA 94104. You can find more information about the trustees and officers in the Statement of Additional Information, which is available free by calling 1-800-435-4000.

Independent Trustees			
Name, Year of Birth, and Position(s) with the trust; (Terms of office, and length of Time Served ¹)	Principal Occupations During the Past Five Years	Number of Portfolios in Fund Complex Overseen by the Trustee	Other Directorships
Mariann Byerwalter 1960 Trustee (Trustee of Schwab Investments since 2000.)	Chairman of JDN Corporate Advisory LLC.	70	<i>Board 1</i> —Director, Redwood Trust, Inc. <i>Board 2</i> —Director, PMI Group, Inc.
Donald F. Dorward 1931 Trustee (Trustee of Schwab Investments since 1989.)	Chief Executive Officer, Dorward & Associates (corporate management, marketing and communications consulting firm). <i>From 1996-1999</i> , Executive Vice President and Managing Director, Grey Advertising. <i>Prior to 1996</i> , President and Chief Executive Officer, Allen & Dorward Advertising.	59	None.
William A. Hasler 1941 Trustee (Trustee of Schwab Investments since 2000.)	Dean Emeritus, Haas School of Business, University of California, Berkeley. <i>Until February 2004</i> , Co-Chief Executive Officer, Aphton Corp. (bio-pharmaceuticals).	70	<i>Board 1</i> —Director, Mission West Properties <i>Board 2</i> —Director, TOUSA <i>Board 3</i> —Director, Harris-Stratex Networks <i>Board 4</i> —Director, Genitope Corp. <i>Board 5</i> —Director & Non-Executive Chairman, Solectron Corp. <i>Board 6</i> —Director, Ditech Networks
Robert G. Holmes 1931 Trustee (Trustee of Schwab Investments since 1989.)	Chairman, Chief Executive Officer and Director, Semloh Financial, Inc. (international financial services and investment advisory firm).	59	None.
Gerald B. Smith 1950 Trustee (Trustee of Schwab Investments since 2000.)	Chairman, Chief Executive Officer and founder of Smith Graham & Co.(investment advisors).	59	<i>Board 1</i> —Board of Cooper Industries <i>Board 2</i> —Chairman of the Audit Committee of Oneok Partners LP
Donald R. Stephens 1938 Trustee (Trustee of Schwab Investments since 1989.)	Managing Partner, D. R. Stephens & Company (investments).	59	None.

Independent Trustees continued

Name, Year of Birth, and Position(s) with the trust; (Terms of office, and length of Time Served ¹)	Principal Occupations During the Past Five Years	Number of Portfolios in Fund Complex Overseen by the Trustee	
			Other Directorships
Michael W. Wilsey 1943 Trustee (Trustee of Schwab Investments since 1989.)	Chairman, Chief Executive Officer, Wilsey Bennett, Inc. (real estate investment and management, and other investments).	59	None.

Interested Trustees

Name, Year of Birth, and Position(s) with the trust; (Terms of office, and length of Time Served)	Principal Occupations During the Past Five Years	Number of Portfolios in Fund Complex Overseen by the Trustee	
			Other Directorships
Charles R. Schwab² 1937 Chairman and Trustee (Chairman and Trustee of Schwab Investments since 1989.)	Chairman, Chief Executive Officer and Director, The Charles Schwab Corporation, Charles Schwab & Co., Inc.; Chairman and Director, Charles Investment Management, Inc., Charles Schwab Bank, N.A.; Chairman and Chief Executive Officer, Schwab (SIS) Holdings Inc. I, Schwab International Holdings, Inc.; Chief Executive Officers and Director, Schwab Holdings Inc. Through June 2007, Director, U.S. Trust Company, N.A., U.S. Trust Company of New York. Until May 2003, Co-Chief Executive Officer, The Charles Schwab Corporation.	59	None
Randall W. Merk² 1954 Trustee (Trustee of Schwab Investments since 2005.)	Executive Vice President and President, Schwab Financial Products, Charles Schwab & Co. Inc.; Director, Charles Schwab Asset Management (Ireland) Limited and Charles Schwab Worldwide Funds PLC. From September 2002 to July 2004, Chief Executive Officer and President, Charles Schwab Investment Management, Inc. and Executive Vice President, Charles Schwab & Co., Inc.	70	None.

Officers of the Trust

Name, Year of Birth, and Position(s) with the trust; (Terms of office, and length of Time Served ³)	Principal Occupations During the Past Five Years
Randall W. Merk 1954 President and Chief Executive Officer (Officer of Schwab Investments since 2007.)	Executive Vice President and President, Schwab Financial Products, Charles Schwab & Co. Inc.; Director, Charles Schwab Asset Management (Ireland) Limited and Charles Schwab Worldwide Funds PLC. From September 2002 to July 2004, Chief Executive Officer and President, Charles Schwab Investment Management, Inc. and Executive Vice President, Charles Schwab & Co., Inc.

Officers of the Trust continued

Name, Year of Birth, and Position(s) with the trust; (Terms of office, and length of Time Served³)

Principal Occupations During the Past Five Years

<p>George Pereira 1964 Treasurer and Principal Financial Officer (Officer of Schwab Investments since 2004.)</p>	<p>Senior Vice President and Chief Financial Officer, Charles Schwab Investment Management, Inc. Chief Financial Officer, Laudus Trust and Laudus Variable Insurance Trust. Director, Charles Schwab Worldwide Fund, PLC and Charles Schwab Asset Management (Ireland) limited. Through June 2007, Treasurer, Chief Financial Officer and Chief Accounting Officer, Excelsior Funds Inc. Excelsior tax-Exempt Funds, Inc. and Excelsior Funds Trust, Chief Financial Officer, Mutual Fund Division, UST Advisors, Inc. From December 1999 to November 2004, Sr. Vice President, Financial Reporting, Charles Schwab & Co. Inc.</p>
<p>Kimon Daifotis 1959 Senior Vice President and Chief Investment Officer-Fixed Income (Officer of Schwab Investments since 2004.)</p>	<p>Senior Vice President and Chief Investment Officer-Fixed Income, Charles Schwab Investment Management, Inc. Prior to 2004, Vice President and Sr. Portfolio Manager, Charles Schwab Investment Management Inc.</p>
<p>Jeffrey Mortimer 1963 Senior Vice President and Chief Investment Officer-Equities (Officer of Schwab Investments since 2004.)</p>	<p>Senior Vice President and Chief Investment Officer-Equities, Charles Schwab Investment Management, Inc.; Vice President and Chief Investment Officer, Laudus Trust and Laudus Variable Insurance Trust. Prior to 2004, Vice President and Sr. Portfolio Manager, Charles Schwab Investment Management, Inc.</p>
<p>Randall Fillmore 1960 Chief Compliance Officer and AML Officer (Officer of Schwab Investments since 2002.)</p>	<p>Senior Vice President and Chief Compliance Officer, Charles Schwab Investment Management, Inc.; Senior Vice President Charles Schwab & Co. Inc., Chief Compliance Officer, Laudus Trust and Laudus Variable Insurance Trust. Through June 2007, Chief Compliance Officer, Excelsior Funds Inc., Excelsior Tax-Exempt Funds, Inc., Excelsior Funds Trust. From 2002 to 2003, Vice President, Charles Schwab & Co., Inc., and Charles Schwab Investment Management, Inc.</p>
<p>Koji E. Felton 1959 Secretary and Chief Legal Officer (Officer of Schwab Investments since 1998.)</p>	<p>Senior Vice President, Chief Counsel and Corporate Secretary, Charles Schwab Investment Management, Inc.; senior Vice President and Deputy General Counsel, Charles Schwab & Co., Inc. Through June 2007, Chief Legal Officer, Excelsior Funds Inc., Excelsior Tax Exempt Funds, Inc. and Excelsior Funds Trust.</p>
<p>Catherine MacGregor 1964 Vice President (Officer of Schwab Investments since 2005.)</p>	<p>Vice President, Charles Schwab & Co., Inc. Charles Schwab Investment Management, Inc., Laudus Trust and Laudus Variable Insurance Trust; since 2006, Chief Counsel, Laudus Trust and Variable Insurance Trust. Until July 2005, Senior Associate, Paul Hastings Janofsky & Walker LLP.</p>
<p>Cathy Sabo 1964 Vice President (Officer of Schwab Investments since 2005.)</p>	<p>Vice President, Compliance, Charles Schwab Investment Management, Inc., Laudus Trust and Laudus Variable Insurance Trust. Until 2004, Vice President, Client, Sales & Services Controls, Charles Schwab & Co., Inc.</p>
<p>Michael Haydel 1970 Vice President (Officer of Schwab Investments since 2006.)</p>	<p>Vice President, Asset Management Client Services, Charles Schwab & Co., Inc.; Vice President and AML Officer, Laudus Trust and Laudus Variable Insurance Trust. Until March 2004, Director Charles Schwab & Co., Inc.</p>

¹ Trustees remain in office until they resign, retire or are removed by shareholder vote. The Schwab Funds retirement policy requires that independent trustees elected after January 1, 2000 retire at age 72 or after 20 years of service as a trustee, whichever comes first. Independent trustees elected prior to January 1, 2000 will retire on the following schedule: Messrs. Holmes and Dorward will retire on December 31, 2007, and Messrs. Stephens and Wilsey will retire on December 31, 2010.

² In addition to their employment with the investment advisor and the distributor, Messrs. Schwab and Merk also own stock of The Charles Schwab Corporation. Mr. Schwab and Mr. Merk are Interested Trustees because they are employees of Schwab and/or the advisor.

³ The President, Treasurer and Secretary hold office until their respective successors are chosen and qualified or until he or she sooner dies, resigns, is removed or becomes disqualified. Each other officer serves at the pleasure of the Board.

Glossary

Alternative Minimum Tax (AMT) A federal income tax designed to limit the extent to which high-income taxpayers (including individuals, estates, trusts and corporations) can benefit from certain deductions and exemptions. For example, some types of income that are exempt from regular federal income tax are not exempt from the AMT.

asset allocation The practice of dividing a portfolio among different asset classes, with each asset class assigned a particular percentage.

asset-backed securities Bond or other debt securities that represent ownership in a pool of assets such as credit card debt.

asset class A group of securities with similar structure and basic characteristics. Stocks, bonds and cash are the three main examples of asset classes.

average rate The average rate of interest paid annually by the fixed-income securities in a fund or portfolio.

bond A security representing a loan from the investor to the issuer. A bond typically pays interest at a fixed rate (the 'coupon rate') until a specified date (the 'maturity date'), at which time the issuer returns the money borrowed ("principal" or "face value") to the bondholder. Because of their structure, bonds are sometimes called "fixed income securities" or 'debt securities.'

An individual bond is subject to the credit risk of the issuer. Changes in interest rates can affect a bond's market value prior to call or maturity. There is no guarantee that a bond's yield to call or maturity will provide a positive return over the rate of inflation.

bond fund A bond fund is subject to the same credit, interest rate, and inflation risks as bonds. In addition, a bond fund incurs ongoing fees and expenses. A bond fund's net asset value will fluctuate with the price of the underlying bonds and the portfolio turnover activity; return of principal is not guaranteed.

call An early repayment of a bond's principal by the issuer, usually done because the issuer is able to refinance its bond debt at a lower rate.

call protection A term used in reference to a bond that cannot be called by the issuer before maturity, or at least for many years from the present date. A bond that offers call protection can more reliably be expected to provide a given yield over a given number of years than a bond that could be called (assuming both bonds are of the same credit quality).

capital gain, capital loss The difference between the amount paid for an investment and its value at a later time. If the investment has been sold, the capital gain or loss is considered a realized gain or loss. If the investment is still held, the gain or loss is still "on paper" and is considered unrealized.

certificate of participation A municipal bond that is repaid from an annual budget appropriation rather than being backed by the full faith and credit of the issuer.

coupon, coupon rate The annual rate of interest paid until maturity by the issuer of a debt security.

credit-enhanced securities Securities that are backed by the credit of an entity other than the issuer (such as a financial institution). Credit enhancements, which can equal up to 100% of the security's value, are designed to help lower the risk of

default on a security and may also make the security more liquid.

credit quality The capacity of an issuer to make its interest and principal payments. See chart below.

credit risk The risk that a bond issuer may be unable to pay interest or principal to its bondholders.

discount rate The implied rate on a debt security that does not pay interest but is bought at a discount and redeemed at face value when it matures.

dividend Money from earnings that is distributed to shareholders as a given amount per share.

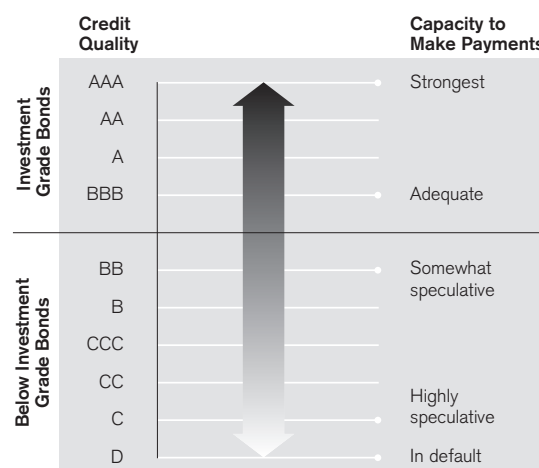
duration A measure of a bond's sensitivity to interest rates. Calculations of duration generally take into account the investment's yield, interest payments, maturity date and call features. Like maturity, duration is expressed in years, but is more accurate than maturity in determining the effect of interest rate movements on a bond investment's price. The duration of a portfolio equals the market value weighted average of the duration of the bonds held in the portfolio.

expense ratio The amount that is taken from a mutual fund's assets each year to cover the fund's operating expenses. An expense ratio of 0.50% means that a fund's expenses amount to half of one percent of its average net assets a year.

general obligation bonds Municipal bonds that are secured by the issuer's full faith and credit, which typically is backed by the power of the issuer to levy taxes.

Credit Ratings

Most major bond issuers arrange with a recognized independent rating organization, such as Standard & Poor's (S&P) or Moody's Investors Service, to rate the creditworthiness of their bonds. The spectrum of these ratings is divided into two major categories: investment grade and below investment grade (sometimes called 'junk bonds'). Bonds rated below investment grade range from those that are considered to have some vulnerability to default to those that appear on the brink of default or are in default.



interest Payments to bondholders (usually made twice a year) as compensation for loaning the bond principal to the issuer.

interest rate risk The risk that a bond's value will fluctuate if market interest rates change or are expected to change. Bond prices tend to move in the opposite direction of interest rates: when interest rates rise, bond prices tend to fall.

liquidity-enhanced security A security that when tendered is paid from funds advanced by an entity other than the issuer (such as a large financial institution). Liquidity enhancements are often used on variable-rate securities where the portfolio manager has an option to tender the securities prior to their final maturity.

market risk Those elements of risk that are common to all securities in an asset class, and therefore cannot be significantly reduced by diversification within the asset class. Also known as "systematic risk."

maturity The date a debt security is scheduled to be "retired" and its principal amount returned to the bondholder.

mortgage-backed securities Bond or other debt securities that represent ownership in a pool of mortgage loans.

muni, municipal bonds, municipal securities Debt securities issued by a state, its counties, municipalities, authorities and other subdivisions, or the territories and possessions of the United States and the District of Columbia, including their subdivisions, agencies and instrumentalities and corporations. These securities may be issued to obtain money for various public purposes, including the construction of a wide range of public facilities such as airports, bridges, highways, housing, hospitals, mass transportation, public utilities, schools, streets, and water and sewer works.

net asset value (NAV) The value of one share of a mutual fund. NAV is calculated by taking the fund's total assets, subtracting liabilities, and dividing by the number of shares outstanding.

outstanding shares, shares outstanding When speaking of a company or mutual fund, indicates all shares currently held by investors.

prepayment risk The risk that a mortgage-backed security may be paid off early, typically because interest rates have fallen and the homeowners who hold the underlying mortgages have refinanced those mortgages at lower rates. In this type of

situation, the investor who held the mortgage-backed security will usually have to settle for a lower rate when reinvesting the principal.

restricted securities Securities that are subject to contractual restrictions on resale. These securities are often purchased in private placement transactions.

revenue bonds Municipal bonds that are issued to finance public works projects and are secured by revenue generated by the project (such as water and sewer fees) rather than the full faith and credit of the issuer.

section 4(2)/144A securities Securities exempt from registration under Section 4(2) of the Securities Act of 1933. These securities may be sold only to qualified institutional buyers under Securities Act Rule 144A.

taxable-equivalent yield The yield an investor would need to get from a taxable investment in order to match the yield paid by a given tax-exempt investment, once the effect of all applicable taxes is taken into account. For example, if your tax rate were 25%, a tax-exempt investment paying 4.5% would have a taxable-equivalent yield for you of 6.0% ($4.5\% \div [1 - 0.25] = 6.0\%$).

total return The percentage that an investor would have earned or lost on an investment in the fund assuming dividends and distributions were reinvested.

weighted average For mutual funds, an average that gives the same weight to each security as the security represents in the fund's portfolio.

weighted average maturity For mutual funds, the maturity of all the debt securities in its portfolio, calculated as a weighted average. As a rule, the longer a fund's weighted average maturity, the greater its interest rate risk. Money funds are required to maintain a weighted average maturity of no more than 90 days.

yield The income paid out by an investment, expressed as a percentage of the investments market value.

yield to maturity The annualized rate of return a bondholder could expect if the bond were held to maturity. In addition to interest payments, yield to maturity also factors in any difference between a bond's current price and its principal amount, or face value.

Notes

Schwab Funds® offers you an extensive family of mutual funds, each one based on a clearly defined investment approach and using disciplined management strategies. The list at right shows all Schwab Funds.

Whether you are an experienced investor or just starting out, Schwab Funds can help you achieve your financial goals. An investor should consider a fund's investment objectives, risks, charges and expenses carefully before investing or sending money. This and other important information can be found in the fund's prospectus. Please call 1-800-435-4000 for a prospectus and brochure for any Schwab Fund. Please read the prospectus carefully before you invest. This report must be preceded or accompanied by a current prospectus.

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A description of the proxy voting policies and procedures used to determine how to vote proxies on behalf of the funds is available without charge, upon request, by visiting Schwab's website at www.schwab.com/schwabfunds, the SEC's website at www.sec.gov, or by contacting Schwab Funds at 1-800-435-4000.

Information regarding how a fund voted proxies relating to portfolio securities during the most recent twelve-month period ended June 30 is available, without charge, by visiting Schwab's website at www.schwab.com/schwabfunds or the SEC's website at <http://www.sec.gov>.

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¹ Investments in money market funds are neither insured nor guaranteed by the Federal Deposit Insurance Corporation (FDIC) or any other government agency and, although they seek to preserve the value of your investment at \$1 per share, it is possible to lose money.

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