

Determined to *Deliver*



2010 ANNUAL REPORT





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Letter from Management

Rochester Public Utilities was challenged with an unprecedented combination of events in 2010 – minimal growth in electricity and water sales, employee furloughs to balance finances, and one of the worst wind and rain storms to besiege Rochester in decades. Our Utility Board and staff have worked diligently to meet these challenges without interrupting our vital services to Rochester residents and businesses.

Retail revenue in 2010 was up modestly in our electric utility, but dropped slightly in the water utility, compared to 2009. We were encouraged by a 3.5 percent increase in electric retail revenue. This boost of just over \$4 million in sales came while RPU fielded its largest energy conservation effort to date. Our employees helped customers – both residential and commercial – reduce power use by over 19 million kilowatt-hours (kWh) during the year.

“The challenges we face as the municipal electric and water utility of Rochester should not impact the quality of service our customers have come to expect from us.”

– Larry Koshire, RPU General Manager



Meanwhile, an unusually wet summer led to a decline in water sales from the prior year. Our system pumped 4.46 billion gallons this year, which was down about 4.5 percent from approximately 4.67 billion gallons in 2009. Retail revenue in the water utility remained flat at \$7.4 million.

We also introduced our water conservation rate program. Adopted by the Utility Board, with final approval from the City Council, the water conservation rates went into effect on April 1. As part of our conservation efforts, RPU introduced a full range of customer rebates for buying water-efficient appliances and equipment. Although it is still early to measure the effectiveness of these programs, we are optimistic that the rebates, coupled with the new conservation rates, and customer education will reduce water usage significantly in the long run.

We continued to be mindful of the economic times and held the line on spending this year, operating our utilities at 2009 levels. For example, all of our full-time employees took furloughs totaling 64 hours between October 2009 and December of this year, resulting in a savings of more than \$430,000. Through other reductions, budget adjustments, and sound financing we were able to eliminate or defer approximately \$9.9 million worth of expenses this year. These efforts allowed us to operate in 2010 without an increase in water or electric rates.

“This approach is truly the ‘new normal’ for how RPU will operate.”

– Larry Koshire

This year, we were able to put long-lasting litigation concerning Southern Minnesota Municipal Power Agency (SMMMPA) behind us. The final judge’s order cited findings favoring both parties, and neither party appealed. We continue to support the best interests of our customers and will work to move forward.

Employee and customer safety is one core area where we can’t compromise. Our goal is to have zero workplace accidents every day. In the past, we have worked with the safety coordinator for our state association, Minnesota Municipal Utilities Association (MMUA), to enhance our internal safety programs. In July, we added a full-time safety manager to oversee our safety initiatives. Having this expertise available at all times will help us build an even stronger safety culture within RPU.

Safety also played an essential role this summer as our employees dealt with severe wind storms. Some of the most dangerous and powerful storms in decades swept through Rochester in June, knocking over trees and blowing debris into power lines. More than 8,000 separate outages were reported within a span of just three days. The widespread outages taxed the abilities of our line crews, and we turned to Minnesota Municipal Utilities Association for assistance. Crews from Austin, Owatonna, and Elk River quickly rushed to our aid. With the help of these mutual aid crews, we repaired lines and returned power to all of our customers in two days. The emergency was historic; it marked the first time that RPU had called for mutual aid.

2010 brought continued success to our conservation and renewable efforts. Solar and wind generation was installed at the Cascade Meadow Wetlands and Environmental Science Center. In addition, the Mayo Clinic installed a 145.5 kilowatt solar energy system on the roof of the Damon Parking Ramp in downtown Rochester. RPU supported this renewable energy installation with a solar equipment rebate amounting to \$145,500. Mayo’s large solar array is a top-quality system that provides a great example of how to tap into renewable energy and reduce our reliance on fossil fuels for energy.

This year we again applied for the American Public Power Association’s RP₃[®] award, which we have earned twice before. APPA applauded our reliability and customer service by honoring RPU with the top Diamond level award for a

“The hard work of RPU staff and the crews from Austin, Owatonna, and Elk River was invaluable in dealing with the summer storm damage. The most important thing over the course of the repair is no one was injured and we were able to restore power to all of our customers in a few days.”

– Larry Koshire

third straight time. RPU is one of only two public utilities in the nation to receive the RP₃[®] Diamond Level Award three consecutive times.

As we move ahead, our efforts and results over the past year reaffirm that we are moving in the right direction for our customers. Sound financial management and prudent decision-making continue to be our sources of success. We look forward to continuing our position as an influential leader in our industry and as a vital asset to the Rochester community. Finally, as we welcome the New Year, we welcome Mark Browning as the newest member of the RPU Utility Board. We also thank outgoing Board member Dick Landwehr for his many years of service to RPU and the citizen ratepayers of Rochester.

Sincerely,

A handwritten signature in black ink that reads "Larry J. Koshire". The signature is written in a cursive, flowing style.

Larry Koshire, General Manager

A handwritten signature in black ink that reads "Jerry Williams". The signature is written in a cursive, flowing style.

Jerry Williams, Board President

Increasing Education *Opportunities for Customers*

Just three years ago, even owner Jack Remick could not have envisioned what would blossom on his 100 acres of land along 19th Street Northwest in Rochester.

The low-lying land is being transformed into a learning laboratory for the public. Cascade Meadow Wetlands and Environmental Science Center offers an unusual blend of energy and water education never before offered in Rochester.

This year, Cascade Meadow completed its science center, one of Minnesota's most energy-efficient buildings, and began creating an educational resource on a group of wetlands native to the state.

When fully developed, Cascade Meadow will feature both indoor and outdoor exhibits designed to educate the public about energy, water, conservation, and wetlands.

Rochester Public Utilities (RPU) is one of the prime partners in this educational venture led by Remick.

As visitors approach the main parking lot at Cascade Meadow, they immediately see a vertical axis wind turbine designed to catch the wind and generate electricity. Relatively small in size at 1 kilowatt (1kW) of generating capacity, the turbine should produce approximately 750 kilowatt-hours (kWh) annually, or about one month's worth of electricity for a typical Rochester home.

The most prominent renewable energy feature is a horizontal axis wind turbine standing more than 100 feet in the air. Rated at 10 kilowatts (10kW), it is expected to produce approximately 18,000 kWh annually, enough to power two homes for an entire year. Both wind turbines were provided by RPU.

On the east side of the new science center building there are three photovoltaic arrays. They range in size from 615 watts to 820 watts. Each solar station uses a different combination of technologies to track the sun and collect its energy. In addition, a separate solar collector owned by Cascade Meadow heats all of the domestic water for the new facility.

Meanwhile, a geothermal system provides heating and cooling needs for the 16,000-square-foot building. The system absorbs or rejects heat from a large pond on site. Using the pond water as a heat source, or sink, the geothermal system transfers heat for use inside the Cascade Meadow building.

“The participation of RPU at the Cascade Meadow project makes power production data and construction experience available so RPU customers may make informed decisions on solar and wind projects.”

– Tom Williamson, RPU Senior Project Engineer

Cascade Meadow's
Vertical Axis
Wind Turbine



Photos by Josh Banks
www.banksphotos.com



Cascade Meadow also offers permanent exhibits about energy and water resources inside the building. The largest is the RPU CONSERVE & SAVE® Energy Fun House. Covering more than 800 square feet, the Energy Fun House will delight visitors with interactive exhibits designed to explore sources of energy and to show ways to save electricity and water with common appliances in their homes. Visitors may search out “phantom” electrical loads – power use that is not obvious to many people. They’ll find displays about conservation in home heating and window installations. Every exhibit gives visitors useful energy ideas to take away from the experience.

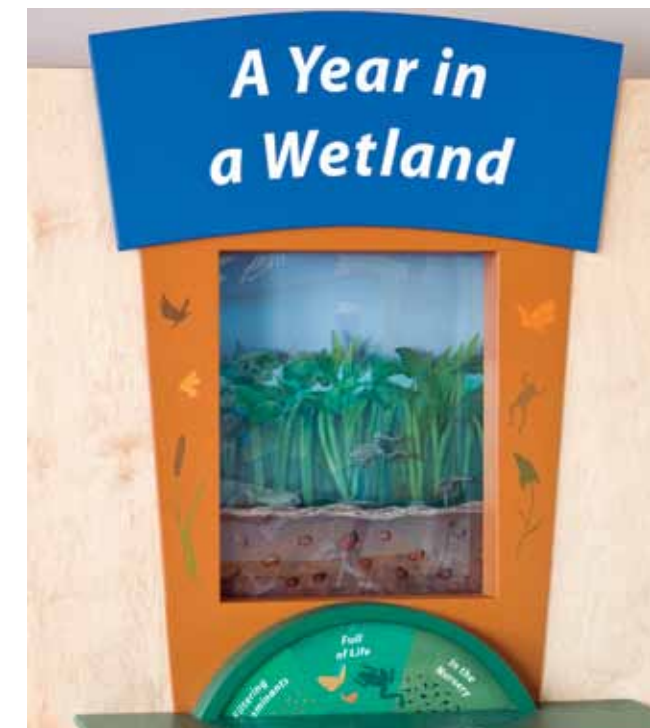
Nearby in the science center, visitors will discover their “Water Connections” through an educational display. They will follow vibrant movements of flashing lights that animate the water systems in their community – from RPU’s storage tower, which supplies drinking water for residential and commercial uses to the sewers that carry storm water off streets. RPU joined with the city of

Rochester’s Public Works Department and the Rochester Water Reclamation Plant to light up Water Connections.

Visitors will also learn about the native wetlands being redeveloped at Cascade Meadow at two exhibits. A sculpted model of the site shows contours of the land and outlines each type of wetland being planted. It also depicts man-made structures including the roads, trails, parking lot, building, and rain gardens.

The wetlands at Cascade Meadow will move through growth phases at different times of the year. “Understanding Wetlands,” an interactive mechanical theater, will help explain these seasonal cycles and their purposes. Visitors will see a wetland scene as it goes through its annual changes.

RPU and the Public Works Department plan to extend the educational reach at Cascade Meadow by installing two additional energy and water exhibits in 2011.



Photos by Josh Banks
www.banksphotos.com

Continuing to CONSERVE & SAVE®

RPU has a responsibility to conserve energy by working with customers to help them make educated, energy-efficient decisions.

ELECTRIC EFFICIENCY

This year RPU captured more than 19 million kilowatt-hours (kWh) of energy savings, primarily by working with residential and commercial customers on energy efficiency projects. That easily exceeded the 16 million kWh saved in 2009, RPU's prior record for energy conservation. This type of increase over the span of a single year can only be achieved through dedicated work and collaboration. Many local contractors partner with RPU as Energy Solutions Partners (ESP) to help local businesses and organizations get the most out of their plans for energy efficiency.

"We have never worked harder or been more focused on energy conservation than we were this past year."

— RPU Marketing Team



WATER EFFICIENCY

While RPU water rates are among the lowest in the state and region, efforts are still necessary to increase preservation of our most precious resource. With the support and approval of the Utility Board, water conservation rates were implemented and rebates for water-efficient purchases were launched this year to provide incentive to customers to reduce water usage.

The water conservation rates were mandated by the Minnesota Department of Natural Resources (DNR) because of RPU's need for construction of an additional well. After approval of the conservation rates by the DNR, the new rate structure was implemented in April. The water rates are laid out in three blocks and offer a lower price per unit, for less water used. The new rate structure applies only to residential customers and to commercial customers with an irrigation meter.

In an effort to help customers lower their water usage and their water bill, RPU rolled out rebates for purchases of water-efficient equipment, such as low-flow toilets and rotating sprinkler nozzles. Launched in the summer under the CONSERVE & SAVE® umbrella of offerings, the water rebates work in a similar fashion to rebates for electric energy-saving devices.



SPOTLIGHT ON PARTNERING IN ENERGY SOLUTIONS...



Chuck Dixon, owner of Rest Assured Mattress Company, was searching for energy savings, when he came to **Shaun Hall of Mr. Electric (ESP)** and **Stephanie Humphrey of RPU.** After analyzing his building's electrical use, together they found an opportunity to save thousands of kilowatt-hours of energy each year in lighting.

The manufacturing floor and showroom were illuminated by 100 T12 fluorescent fixtures. Chuck could reduce his business' electric use permanently by switching to more efficient T8 lighting. He was convinced, so the **T12 ballasts and bulbs were replaced with an energy-efficient T8 system.**

Stephanie and Shaun estimated Chuck would **save almost 24,000 kilowatt-hours of energy use every year** compared to his past system. They also projected the savings would be large enough to repay the costs of the retrofit project in less than one year. In addition, Chuck would **receive a \$1,642 rebate from RPU,** which included a bonus rebate through RPU's T12 Roundup program.

After successful completion of the lighting project, Chuck is already planning more energy efficiency projects for 2011.



Summer of 2010

Minnesota summers tend to be unpredictable. Temperatures can fluctuate and the humidity, at times, can be almost unbearable. In those times of high humidity and heat, the reliability of our electric system is a paramount concern. In the months leading up to the summer, RPU made preparations to strengthen the system with projects such as pole replacements, installation of additional switchgear, and regular tree trimming.

Electric demand for 2010 rose slightly over past years, due in part to the warmer weather. Usage in the residential customer class was up over 6% from last year, with some of that usage attributed to air conditioning usage during the summer months. Not as affected by weather factors, the commercial and industrial customer demand for power changed relatively little from 2009 levels. Peak electric use topped out at 278 megawatts on August 11.

Wet summer weather helped to decrease water usage in 2010 compared to previous years. RPU's annual water pumpage tallied 4.46 billion gallons pumped in 2010, down slightly from 4.67 billion gallons pumped in 2009. The launch of rebates for water-efficient equipment purchases also may have contributed to the decline in water use.

Violent weather affected RPU operations in mid-June when a severe wind storm and tornado swept through Rochester and southern Minnesota. The winds knocked over trees and blew debris into power lines; in some cases, they toppled whole lines and poles. More than 8,000 customers were affected by interruptions in electric service ranging from a few minutes to many hours.

With the extensive amount of damage, RPU made the first call in its history for mutual aid from other utilities through the Minnesota Municipal Utilities Association

(MMUA). Crews from Austin, Owatonna, and Elk River responded immediately and were working alongside RPU crews later that night.

More than 20 RPU line workers, along with crews from the other utilities, worked tirelessly to restore power to the affected residents of Rochester. RPU also funneled damage updates to the local and state media constantly through social media connections, including our RPU blog, Facebook page and Twitter.

After the storm moved on, the clean-up continued. Trees limbs, tree trunks, utility poles, and other debris had to be removed and disposed of properly. RPU line workers and tree trimming crews were busy not only cleaning up after repairs but also warning customers about the dangers of downed lines and equipment buried in the debris.

"Safety is of the utmost importance when dealing with outages in windy and stormy conditions and the clean up after."

– Pete Bennett, RPU Electric Construction Supervisor



Another wind and rain storm, this time in September, had a significant impact on Lake Zumbro and RPU's hydroelectric plant. Heavy rainfall swelled the water level of Lake Zumbro to elevation 928.61 dam datum, approximately 9 feet above normal summer lake level. Homes and other properties, both above and below the dam, were damaged by flood water.

Based on dam safety investigations and audits performed over the years, RPU management had a high level of confidence in the stability of the facility. However, tremendous water pressure resulted in substantial leakage through the cracks and construction joints in the dam and

powerhouse. The increased head pressure and leakage did not threaten the structure, but as a precautionary measure Power Resources staff monitored the situation, recorded observations and captured the event on photographs. As expected, the 90-year-old plant held firm and as the water slowly receded crews shifted their efforts to restoration and clean up.

During the entire flood event the Emergency Action Plan (EAP) was followed and communications maintained with state, federal and Wabasha County officials. Following the plan helped keep stakeholders informed until the threat passed.



Heavy rainfall swelled the water level of Lake Zumbro to elevation 928.61 dam datum, approximately 9 feet above normal summer lake level.



System Growth

RPU continued to enhance its system and expand its service territory this year. One significant project was the development of the Westside substation, located along 60th Avenue and 19th Street Northwest. Westside will become the 10th RPU substation when fully completed in 2012. In 2010, more than \$2.3 million was spent on the first phase of the project. In addition to serving areas on the west side of Rochester, the substation also will relieve

“The Westside substation was planned to be very flexible and capable of expanding to serve the evolving needs of RPU customers during the upcoming decade. A blend of current technologies and new methods were selected to support these goals.”

– Neil Stiller, RPU Senior Electrical Engineer



From left to right: Pete Minogue (Substation Electrician), Ted Mason (Utility Technician), and Neil Stiller at RPU's Westside substation. Substation staff not pictured are: Bill Schmitz (Substation Electrician) and Jeff Kranz (Lead Utility Technician).

existing substations of load and will possibly house gas turbine generation in future project phases.

This year, the site was prepared; security provisions were put in place, and all major outdoor equipment for phase 1 was installed. In 2011, the Maple Leaf transmission line will be energized and distribution switchgear will be installed. As many as 10 distribution feeders will be served from Westside. Initial plans call for three feeders to be completed in 2012.

RPU also worked diligently to transfer electric service for more than 900 former People's Cooperative Services customers. RPU's service territory expands when Rochester extends its city limits and annexes neighborhoods served by People's Co-op. Residents in those areas were switched to RPU and their meters replaced with minimal interruption in service.

The wholesale energy market continued to be sluggish, and RPU found little financial opportunity to sell power on the Midwest System Operators (MISO) market. This year, the utility's wholesale revenue topped \$5.3 million through sales of 35 million kWh.

Despite the depressed wholesale energy market, RPU's Silver Lake Plant (SLP) was still busy providing steam to the Mayo Clinic and other Mayo buildings. SLP generated more than \$5.5 million in additional revenue through steam sales.

RPU also began laying the ground work to join MISO as a transmission owner after an independent financial analysis was completed. As a transmission owner, RPU would put all of its transmission assets in the MISO service footprint and as a result is entitled to receive revenue for the use of those assets under the FERC-approved revenue recovery method. RPU plans to sign the transmission owner agreement sometime in 2011.





RPU's water utility completed one of its largest projects in recent history – the 50th Avenue “hydropillar.” Construction of the 2 million-gallon storage structure began in September of 2009 and will be finished in June 2011. The hydropillar contains four times the storage capacity of RPU's standard spheroid towers.

THE 50TH AVENUE HYDROPILLAR “BY THE NUMBERS”:

- Cost \$2.8 million to build
- 550 tons of structural steel was used
- 475 yards of concrete was put on site
- 30,000 pounds of reinforcing steel was laid
- 2 million gallon capacity
- Stands over 137 feet tall (RPU's tallest water tower is the Apache Mall tower at 167 feet)
- Increases RPU's total storage capacity to 15.23 million gallons of water

“We take great pride in delivering clean, reliable drinking water to the residents of Rochester.”

– Jay Mullen, RPU Water Operator



Business Decisions

Careful consideration was given when RPU decided to not increase rates in 2010. Understanding that everyone – customers and RPU included – are doing more with less, the Utility Board chose to reduce internal costs rather than increase rates.

One of the most significant contributions was a reduction in work hours by full time employees. Through agreements with the representing unions, employees took furloughs between October 2009 and December 2010,

resulting in a savings of more than \$430,000. Approximately \$9.9 million worth of expenses was eliminated or deferred through other reductions, budget adjustments, and sound financing.

Every effort was needed due to a 4 percent rate increase from RPU's wholesale power provider Southern Minnesota Municipal Power Agency (SMMPA). With the rate increase totaling over \$3.4 million, RPU's total wholesale power cost topped \$88.1 million.

RP₃[®] Designation

RPU was chosen again this year as one of the 94 public power utilities to earn the Reliable Public Power Provider (RP₃[®]) recognition from the American Public Power Association (APPA).

The RP₃[®] designation recognizes public power utilities that demonstrate proficiency in four key disciplines:

- Reliability
- Safety
- Workforce development
- System improvement

RPU also stood out as one of only two utilities to achieve the diamond rating (the highest level in the RP₃[®] recognition) three consecutive times.

This is the fifth year that the RP₃[®] award has been offered. APPA, located in Washington, D.C., is the national organization representing more than 2,000 not-for-profit, community- and state- owned electric utilities.

“We’re honored to receive our RP₃[®] designation. Our utility staff puts in a lot of hard work to provide reliable and safe service to our community. RP₃[®] is a much appreciated recognition of this hard work.

I would especially like to thank Kathy Wilson, Assistant to the General Manager, for her role in managing and assembling the documentation, and completing and filing all three of our RP₃[®] applications.”

– Larry Koshire, RPU General Manager

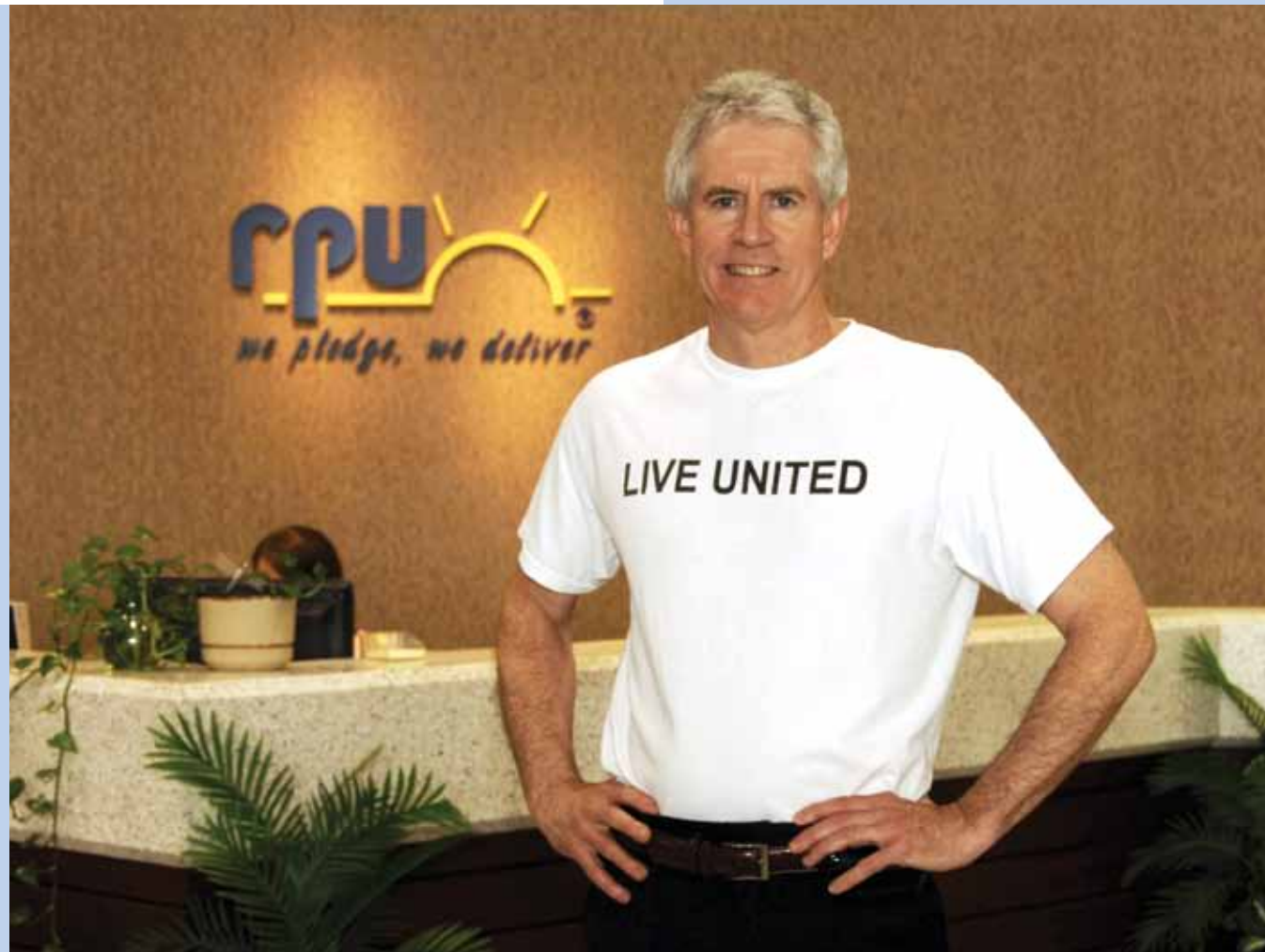


United Way Campaign

Each year RPU employees come together to support the annual fundraising campaign for the United Way of Olmsted County. Events ranging from specialty lunches to an indoor mini-golf competition helped to collect over \$26,000 for the United Way. All of the money raised came directly from current and retired RPU employees.

“Being a part of the United Way campaign is an opportunity to make a difference and to support the community. I consider participating in United Way to be a privilege as well as my responsibility.”

– Joe Hensel, RPU Director of Field Services



Rochester Public Utilities Leadership



Larry Koshire
General Manager



Mark Kotschevar
Director of
Core Services



Susan Parker
Director of
Corporate Services



Joe Hensel
Director of
Field Services



Walter Schlink
Director of
Power Resources

Utility Board



Jerry Williams
Board President
Retired



Dave Reichert
Board Member
*Facilities Engineering
Manager, IBM*



Dick Landwehr
Board Member
*President and CEO,
Mariah Group Inc.*



Roger Stahl
Board Member
*Attorney; Wendland,
Utz, Stahl, Mintz, Ltd.*



Dennis Hanson
Board Member &
City Council Liaison
*City Council
President,
City of Rochester &
Vice President of
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