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2009 annual report

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Emission Reduction Project for Unit 4 at the Silver Lake Plant

2009 Annual Report

2009 Financial Statements

Letter from Management

The year 2009 was a challenging one for Rochester Public Utilities (RPU). It is much easier to deal with factors that are within our control than with external challenges, such as a volatile economy and depressed energy markets. Nonetheless, we met last year's economic downturn head on with financial discipline that will serve us and our customers into the future.

Higher fuel costs and slower sales of electricity affected our core electric business. A cool summer coupled with reductions in operations by local businesses also affected revenues in both of our primary enterprises. As a result, retail sales of electricity declined 5.4 percent compared to the prior year; and water sales decreased 3 percent.

When it became apparent the poor economy wasn't a mere bump in the road, we looked further ahead. We worked through 2009 with the goal of avoiding rate increases for 2010. We cut costs and moved to create a leaner budget. Every budget item, except those assuring safety or quality service to customers, was examined. We deferred projects, optimized existing resources, reduced overtime and cut back consultant expenses in order to control costs and avoid rate increases. The scrutiny paid off as we reduced close to $3 million from the 2009 budget. We deferred another $1.4 million in expenses by moving back projects. Additionally, we borrowed in small amounts to reduce pressure on cash reserves. In an unprecedented effort, we asked our staff to search out every dollar of savings they could find in operations. No reduction was too small! That search alone yielded an additional $500,000 in savings.

In these tough economic times, staff knew that labor costs had to be reviewed. Working closely with the unions that represent our workers, a furlough plan was negotiated that reduced labor expenses while maintaining the current level of full-time equivalent positions.

The overall spending discipline was necessary to offset declining revenue. We experienced decreases in sales to retail customers as well as sales into the energy market from the Silver Lake Plant (SLP). Generators at SLP ran much less than in previous years. Despite the reduction in retail and market sales, we continued to operate SLP's boilers in order to supply high-pressure steam to the Mayo Clinic under our long-term contract.

The generating capacity of the Lake Zumbro hydroelectric plant and the gas turbines at the Cascade Creek Substation proved to be valuable. Having the renewable energy from the hydro and the short notice availability of the gas turbines has been a positive for us during these tough economic times. Both assets were able to be sold into the energy market on a moment's notice.

Customer growth was much slower than in prior years, nonetheless, we expanded our customer base by adding 268 residential and commercial electric customers in 2009.

Weather and the economy also diminished water sales in 2009. Normal rainfall amounts and mild temperatures during the summer were factors leading to a decline of 3 percent in water sales in 2009. Another contributing factor was the continued slowdown in the housing market. Previous years of gains in water sales and cash reserves enabled the water

utility to manage its operations during the economic downturn. We continued to expand the water system by adding a modest 319 water customers in 2009. No water rate increase was needed for 2010.

The leadership of the Rochester Public Utility Board underwent some notable transitions this year. Board President Jack Jibben transitioned off the board after many years of valuable service, and previous member Dick Landwehr graciously agreed to return to the Utility Board to complete Jack's term. Second-year member, Jerry Williams, was elected President of the Board.

During the past year, the Utility Board focused on how RPU will adapt to industry changes in the years to come. The board set an important course for the future by declining to renew its contract to purchase power from the Southern Minnesota Municipal Power Agency (SMMPA) beyond expiration of our current contract in 2030. The Utility Board also dedicated the $38 million Emission Reduction Project (ERP) at the Silver Lake Power Plant in spring 2009. The upgrade installed sophisticated systems to filter airborne particles and chemicals from emissions released by the coal-fired plant. The project was RPU's largest single capital improvement in many years.

We are very proud of our more than 200 RPU employees and the efforts they've put forth over the past year. The challenges presented by the economy and the soft energy market left RPU stronger and better prepared for 2010. Our commitment to provide safe, reliable electricity to our 47,675 electric customers and water to our 36,732 water customers will not change. We will continue to keep rates affordable by making sound, responsible decisions with our customers' needs in the forefront.

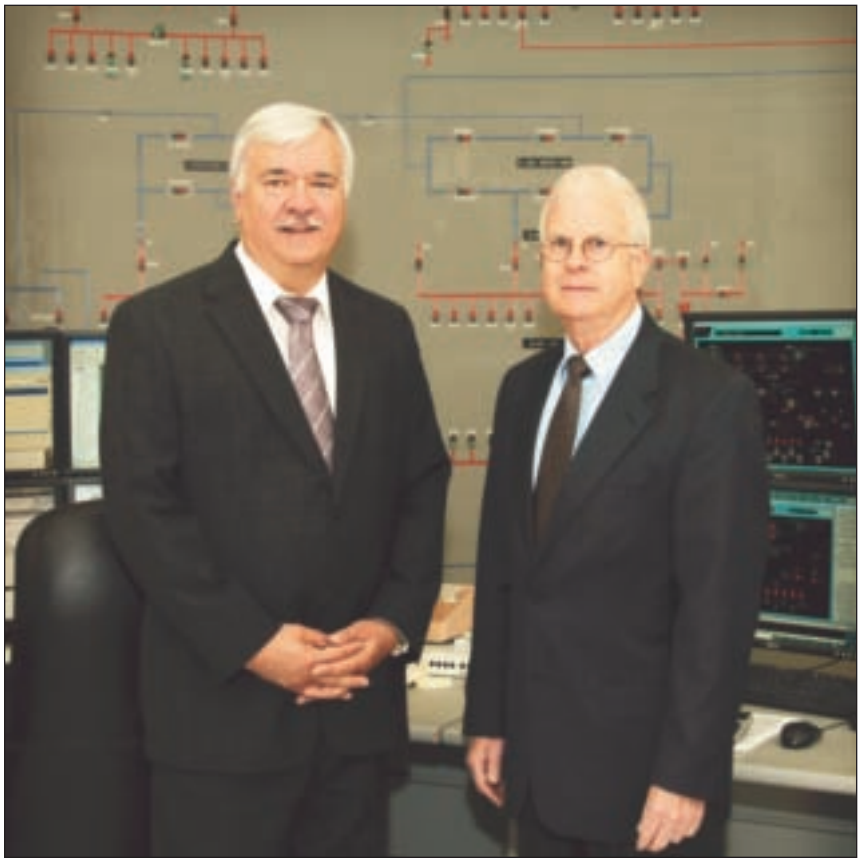
Signed,

Larry J. Koshire

Larry Koshire

Jerry Williams

Jerry Williams



RPU General Manager Larry Koshire (left) and Board President Jerry Williams

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Whether we are generating power

or communicating with our customers,

we work to find and employ

the best technologies available.

More than ever during this past year,

we relied on technology

to improve how we operate.

At the same time,

we also called on technology

to control costs as we prepare

to operate in 2010 without a rate increase

for the water or electric utilities.

Remote Meter Reading

Our metering system is part of our core operations. For many years, reading meters was very labor intensive. The process required an RPU employee to visit customers' homes and businesses with many variables affecting how data was gathered. Today, we are wrapping up a major project that has changed how we gather electricity and water usage data from customer meters.

Our automated meter reading (AMR) system now encompasses all of our residential electric meters and more than 90 percent of our water meters. With AMR, meter readers drive through neighborhoods and gather the information remotely via wireless connection. This replaces the old method of walking house-to-house to manually record meter data.

We have realized multiple efficiencies since the implementation of the AMR system. The direct link between meter and remote reading device has improved data accuracy and virtually eliminated the possibility of a meter being incorrectly read.

AMR has significantly reduced the time needed to collect meter data, allowing us to reduce staff from 11 to three full-time equivalents, while keeping up with the city's growth. The labor and equipment savings total over $1 million per year.

The greatest benefit to installing an AMR system is safety for our workers. Our meter readers face outdoor hazards such as pets, fences and inclement weather. Lessening the exposure of employees to these hazards will have a positive impact on organizational safety.

As new technologies appear and costs for these technologies decrease, we will continue to look at using those enhancements to gather customer information. For example, we have spent significant time investigating a two-way communication system that would allow us not only to receive data but also to communicate with the meter. This upgrade could allow advanced energy conservation measures, more precise billing options and remote troubleshooting of meters.

Meter Reader Glenn Reiter displays AMR capabilities from inside his truck.

Geographic Information System (GIS) is used in numerous parts of RPU operations.

Geographic Information System (GIS)

No matter how convenient or "cutting-edge" a new technology appears, we gauge how it will help employees work more efficiently and safer. The more prepared our electric and water crews are, the safer their work is likely to be. One tool we use in our operations is a geographic information system (GIS), which provides us with an overall picture of our facilities in the field.

In large part, GIS is employed in our outage management system. When a customer calls to report a power outage, our system operators look up the customer's address in a computerized database and enters the information into the outage management system. The system correlates the information and provides probable outage causes. The system also combines outages into groups based on the information provided. This alerts the system operators to possible affected customers even if they have not called in; however, the system still relies on customer reports and the system operator to input the information correctly. Once the outage is restored, the information is automatically stored in another database for review and reporting.

Our water and electric crews use GIS on their laptop computers to search for addresses or devices in the field. Facilities such as transformers, meters, and other infrastructure components are mapped, as well as an aerial photo associated with the location on their laptop screens. The aerial photography makes it easier to locate features that may be out of sight because they are buried in a snow bank or hidden by a row of bushes. Additionally, GIS helps the meter reading staff locate electric meters on a map and give information on which are read remotely and which require a closer look by meter readers.

We employ GIS to design electric service lines in new subdivisions. Information is entered and a design map is created from which cost estimates can be put together for the expansion projects. GIS is also equipped with pictometry, which allows RPU designers to view images in Rochester from four different directions. The computerized software allows our designers to do a large majority of their design work in the office and to reduce the need for trips into the field for verification.

Bamber Valley Substation

System Protection

We have made a significant investment by installing microprocessor-based protective relays in our electrical substations during the past year. Today's relays provide more sophisticated protection for worker safety and customizable control.

For example, we are better equipped to monitor our transmission and distribution system by analyzing how weather and air temperature affect customers' usage. If one part of our system is under too much strain from high summer demand, the relay can detect it and send an alert to reconfigure the distribution system to avoid an outage.

At a more detailed level, the relays can be triggered remotely so work can be completed on a specific section of our distribution system. After the work has been completed, we can reset those safety features remotely, minimizing high voltage exposure and saving time.

Approximately half of our distribution feeders are now protected by microprocessor-based protective relays.

Protective relays inside the Bamber Valley Substation.

Generation Dispatching

We continue to review not just physical assets, but processes and procedures as well. Efficiencies were gained this year by moving dispatch duties directly to staff at the Silver Lake Plant (SLP) from staff at the Service Center. SLP control room employees now handle all dispatch of RPU generation and communication with energy marketers. This change allows for direct communication and increased reliability of information by removing unnecessary layers.

Meanwhile, the Emission Reduction Project (ERP) at SLP, our largest technology project in years, has been in service for almost a year. Engineers took the computerized control system called "Delta V", which had been installed back in 2005, and expanded it for the large project in 2008. "Delta V" provides a high level of automation to control all four units at SLP. The technology eliminates the need for additional operating staff, resulting in a substantial savings in labor costs.

Controls along the turbine floor of the Silver Lake Plant.

Turbine floor of the Silver Lake Plant.

District Energy

Sometimes moving into the future requires undoing the practices of the past. One example of such an initiative was the development of the "export steam" operating mode at SLP. "Export steam" operation means that a boiler is running and producing steam, but that the associated turbine-generator is shutdown. While this sounds simple, it's a significant departure from the historical SLP operating mode. The advent of "export steam" mode was necessitated by the depressed state of the wholesale energy market; depressed to a level significantly below the cost of production. Operating the boiler and turbine-generator in the conventional fashion resulted in a net operating loss. The implementation of a few process control system modifications, coupled with revised operating procedures, eliminated the loss.

Communicating with Customers

Find us on the Web!

The broad appeal of social media over the past few years has revolutionized how people connect and interact. We have enhanced our customer communication by using the Internet and social media venues, such as Facebook and Twitter. Social media brings people together online for dialogue and discussions on an array of topics and ideas. Along with other utilities, we were drawn by the broad appeal and the candid manner of the communication.

We were among a small number of utilities on the cutting edge of electronic communication in 2004, when we launched "Behind the Meter", our Internet blog (http://blog.rpu.org/). Recently, we revamped its design to give customers more ways to react to our postings. At the same time, we set up a Facebook page and began instant messaging on Twitter, two of the Web's most popular services. Our Facebook page offers people a chance to learn what's new with RPU and to share their thoughts. The feedback is valuable and we take those comments into consideration when making decisions. Our presence on Twitter is different from our Facebook page. Twitter provides a fast, direct way to notify the public and the media about an emergency or other immediate situations such as power outages and water main breaks.

RPU's Facebook page launched in 2009.

Social media also connects us to our customers regardless of where they are. In today's wireless world, many people receive social media messages on cell phones rather than by computers. People can receive Twitter updates whether they are vacationing for weeks, or are merely away from home for a few hours.

Our strategy for social media is simple. We want to make it easy for our customers to keep up with what is going on with their utility. Transparency about what we're doing and how we operate is no longer a gesture of good customer service; it's demanded by today's customers.

Fiscal Responsibility

Our preparation today will benefit us tomorrow.

Strong financial management over the past years helped prepare us for the economic downturn in 2009. Like other cities nationwide, Rochester was not insulated from increased unemployment rates, declines in the housing market and fallout from the stock market. RPU felt the effects of the economic times, but through the foresight of our Utility Board, we took the necessary measures to ensure greater financial stability.

We began by increasing our cash reserves. Our reserve levels were $27 million and $5 million respectively for the electric and water utilities going into 2009. In comparison, our 2004 cash reserves were $15.5 million and $1.7 million respectively. By preserving adequate cash reserves, we have maintained favorable bond ratings from both major credit rating firms, Moody's and Fitch. A strong financial position will be beneficial by virtue of lower bond interest rates for securing capital for large infrastructure projects, such as the CapX 2020 transmission project.

In our core operations, we adjusted for the 6 percent increase passed onto us by our wholesale provider, the Southern Minnesota Municipal Power Agency (SMMPA). We put cost cutting measures in force and kept a tight rein on spending to help offset the rate increase. Wholesale power from SMMPA is our single largest expense. In 2009, SMMPA accounted for 67 cents of every dollar collected in retail revenue.

As financial pressures mounted, we also adjusted our budgeting with a process called "reforecasting." The purpose of reforecasting the budget is to keep a closer eye on expenses and identify future cost-saving measures. We now reforecast twice a year: in May and then again in August.

As a municipal utility, owned and operated by the City of Rochester, we do not pay city tax but do put money back into the city's general fund in the form of in-lieu-of-tax payments. By the end of 2009, the water and electric utilities transferred more than $8.5 million to the City of Rochester.

Board Member Dennis Hanson (left) and
RPU General Manager Larry Koshire (right)
going over the board agenda during an RPU board meeting.

RPU Lake Zumbro hydroelectric dam.

Environmental Stewardship

Being "green" and "environmentally friendly" have been buzz words lately, but being environmental stewards has been a cornerstone of our business for many years. This past year, we put in place a system to track and measure our progress with environmental stewardship.

We focused our efforts on reducing carbon dioxide (CO^2) because it is critical to the environment. CO^2 is a compound produced in part by burning fossil fuels for power generation. It is also a component of greenhouse gas emissions, which are required to be reported to the EPA beginning in 2010.

In 2009, we started to chart the reductions in CO^2 emissions resulting from our energy conservation efforts and generation mix. With this data we will have a good base from which to measure our efforts to greater reduce our emissions in the coming years.

Through our Conserve & Save program, we worked with customers and local trade allies to reduce power consumption by over 16 million kilowatt hours (kWh) in 2009. That amount of energy is equal to the annual electric usage of about 1,666 households in Rochester.

Conserve & Save continues to offer customers rebates to choose energy-efficient equipment and appliances, rather than standard models. The program also provides energy education to help customers make more informed decisions regarding their energy use.

We are continuing to expand our Conserve & Save rebate offerings for both commercial and residential customers. This past year we added Energy Star® light-emitting diode (LED) fixtures and rain barrels to our residential rebates.

RPU now offers a Conserve & Save rebate on rain barrels.

Partnering in Energy Solutions

In 2009, we experienced an increase in the number of commercial customers taking advantage of no-interest Energy Efficiency Financing, which is available through our Partnering in Energy Solutions program. It offers customers the money up front to pay for their projects; customers return the cost to RPU over the course of one or two years at no interest.

Partnering in Energy Solutions Business Highlight

PERKINS RESTAURANT – Two Locations
- Installed Energy Efficient Kitchen Vent Hoods

Energy Solutions Partner: Energy Advantage
Conserve & Save Custom Rebate: $1,666
Annual kWh Savings: 59,564

Commercial customers can take advantage of our Green Financing Program that aims to help customers obtain "green" status. We will finance up to $25,000 for a customer's project on costs associated with achieving the building certification of their choice. "Green" status can include building certification in Energy Star®, Leadership in Energy and Environmental Design (LEED), or Green Globes.

While these rebates and financing arrangements help to build energy-efficient projects, the real rewards come year after year through lower electric usage.

RPU has been working to reduce its carbon footprint by helping customers interested in installing renewable energy

Partnering in Energy Solutions Business Highlight

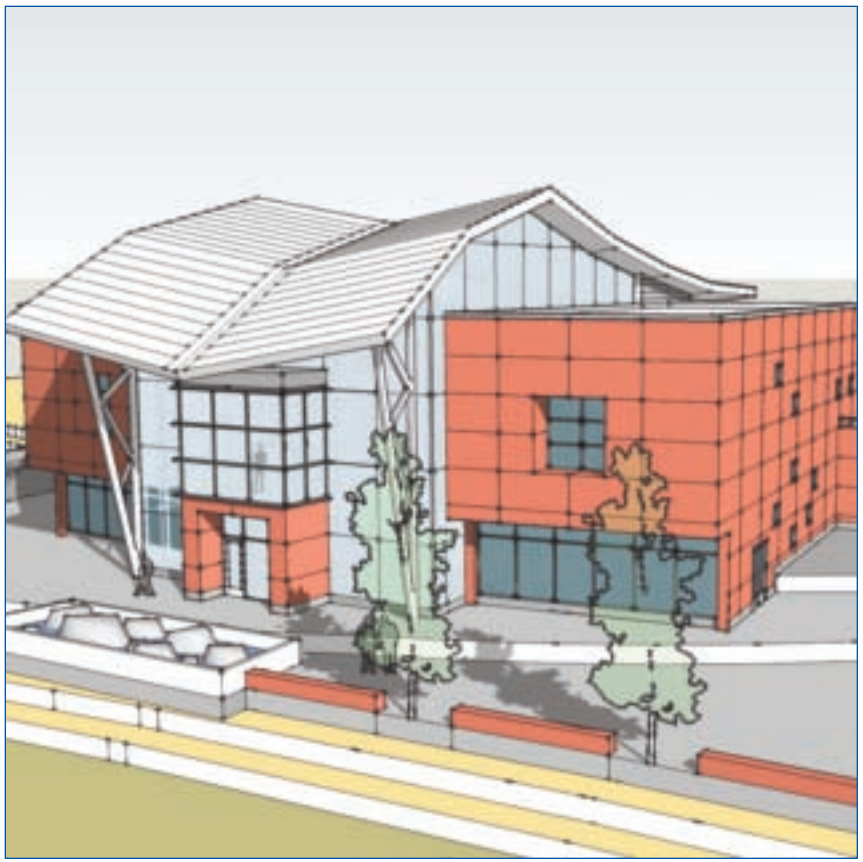
ADAMSON MOTORS
- Replaced Old CRT Monitors with LCD's
- Replaced Old Compressor System
- Installed Energy Efficient Lighting

Energy Solutions Partner: Mr. Electric (lighting)
Conserve & Save Rebates: $8,633
Annual kWh Savings: 145,235

products in their home or business. For example, we assisted residential customer, Lisa Boardman, on the first residential wind turbine erected in the Rochester city limits last spring. She installed a 2.6 kilowatt (kW) wind turbine, which is expected to generate more than 400 kWh a month. Lisa was able to do this installation because she owns a large parcel of residential land inside the city limits, allowing for compliance with all city zoning and safety concerns.

We are a key collaborator in the Cascade Meadow Wetlands and Environmental Science Center (CM) now being developed in northwest Rochester. Scheduled to open in September 2010, the 16,000-square-foot facility will be constructed to meet a LEED Platinum certification status. LEED certification provides independent, third-party verification that a building project meets the highest green building and performance measures. Platinum is the highest recognition for building efficiency within LEED. CM is being built and operated by Jack Remick, owner of the Rochester Athletic Club (RAC). Site construction, located on a 100-acre parcel of land just south of the RAC, started in the fall of 2009.

Plans are to display energy and water exhibits both inside and outside the center. Inside, visitors will be able to tour the RPU Conserve & Save Energy Fun House exhibit. Some of the learning opportunities will include examples of how to be energy efficient, how to detect phantom loads, how electricity is measured, and how it translates into dollars and cents. Outside, we will be purchasing and installing wind and solar generation on-site, supplying as much as 7.5 percent of the center's use to satisfy a requirement for LEED certification.



(upper left) 2.6 kW wind turbine installed by RPU customer Lisa Boardman.

(above and upper right) Graphic rendering of the Cascade Meadow Wetlands and Environmental Science Center scheduled to open in September 2010.

Employee Contributions

Our employees continue to step up to help support the Rochester community and others in need. Their dedication can be seen in volunteer work helping local groups and organizations with events and through annual fundraising for the United Way.

Employees provided significant support for the United Way of Olmsted County. We set the most aggressive fundraising goal yet of $24,000 for our internal campaign. Now more than ever, people in Rochester and Olmsted County need the help and resources of the United Way. The campaign, lasting a little over a month netted over $28,000, a new record for money raised by RPU employees and about $4,000 more than the goal.

We found other opportunities throughout the year to share information about RPU and to interact with our customers. They included:

- Drinking Water Taste Test at the Folwell Elementary School's Healthy Living Fair
- Water Tower Open House for National Drinking Water Week
- Arbor Day Celebration, which included tree plantings

Sometimes the call for help came from further distances. On January 26, 2009, an ice storm devastated Kennett, Missouri, dropping more than four inches of snow, sleet, and ice. With a population of 11,260, Kennett was not prepared to handle the extreme conditions that the ice storm left. Power lines and poles broke under the weight of the ice and snow accumulation. Trees fell and hung on power lines. The next day, the Missouri Public Utility Alliance asked the Minnesota Municipal Utilities Association for help and resources. We were able to send two trucks and four line workers to help restore power. The work days were long and working conditions were dangerous for the RPU crew and others who came to the town's aid. After five days of working in Kennett, the RPU crews returned home safely. This was the second time in two years that we were asked to send crews and resources to Missouri. In 2007, we sent a crew to Nixa, Missouri because of ice and wind damage.

RPU Line Workers sent to Kennett, Missouri, were Steve Fiek, Bjorn Olson, Brad Gunderson, Jeff Wagenaar.

" We all remember what we admirably but respectfully called our 'Minnesota Guys'. We have a 40 megawatt power plant here in Kennett that was operating to help keep the power going to the hospital and nursing homes during the time they were here. The lines connecting the hospital were considered a 'priority' and were restored first by our linemen and a couple of other crews that were nearby and could respond quickly. As I recall, Steve and his guys were working up the road in Malden, MO, and once they were finished there, they responded to Kennett. One of the most critical problems we had at the time RPU arrived was

The ice storm in Kennett, Missouri collapsed trees and distribution poles.

rebuilding the 69 kilovolt (kV) radial feeder that linked us to our Southwestern Power Administration feed. Steve and the guys set to work on rebuilding the shattered 69kV feed. We knew we had only a limited supply of reasonably good weather, and it was up to those guys to rebuild the line. It was a big job, but the 'Minnesota Guys' worked quickly with great skill and enthusiasm to get the line rebuilt faster than we could ever have dreamed!

RPU line workers helped assist clean up and restoration efforts after an ice and wind storm in Kennett, Missouri.

"I'm not sure your men realized the full impact of their efforts. Kennett, indeed, none of southeast Missouri had ever faced such a disaster, at least in recorded history. If you ask the guys that were here, I think they will tell you Kennett was the worst hit of the area. Many of the crews that had worked other disasters had never seen damage to the extent it was here in Kennett. Residents sitting in dark, cold houses had only one glimmer of hope; that was, to see the crews from all over, (Missouri, Kansas, Iowa, and where???, did you say Minnesota??!!!) working their hearts out to help them. Many acts of kindness were done by those crews we didn't know about, and likewise, our citizens did many things we weren't aware of. Only a few days ago, on the one-year anniversary of the event, we honored the local radio station with a Certificate of Appreciation for their efforts in the storm (we were too busy to recognize them a year ago!). They had somehow kept one small AM transmitter operating, but this small AM station was the lifeline to most of the people of the region. At some point, they had made mention on the air of the fact that some of the linemen needed a few extra gloves and face masks to help out with the cold. The station manager said the result was overwhelming. They collected box upon box of items that people had dropped by the station! These were distributed to any of the crews that wanted them. The people of Kennett wanted to show their appreciation for the crews anyway they could. We eventually had 23 municipal utilities here helping."

– David Wilkins
Director of Operations for
Kennett City Light, Gas, and Water

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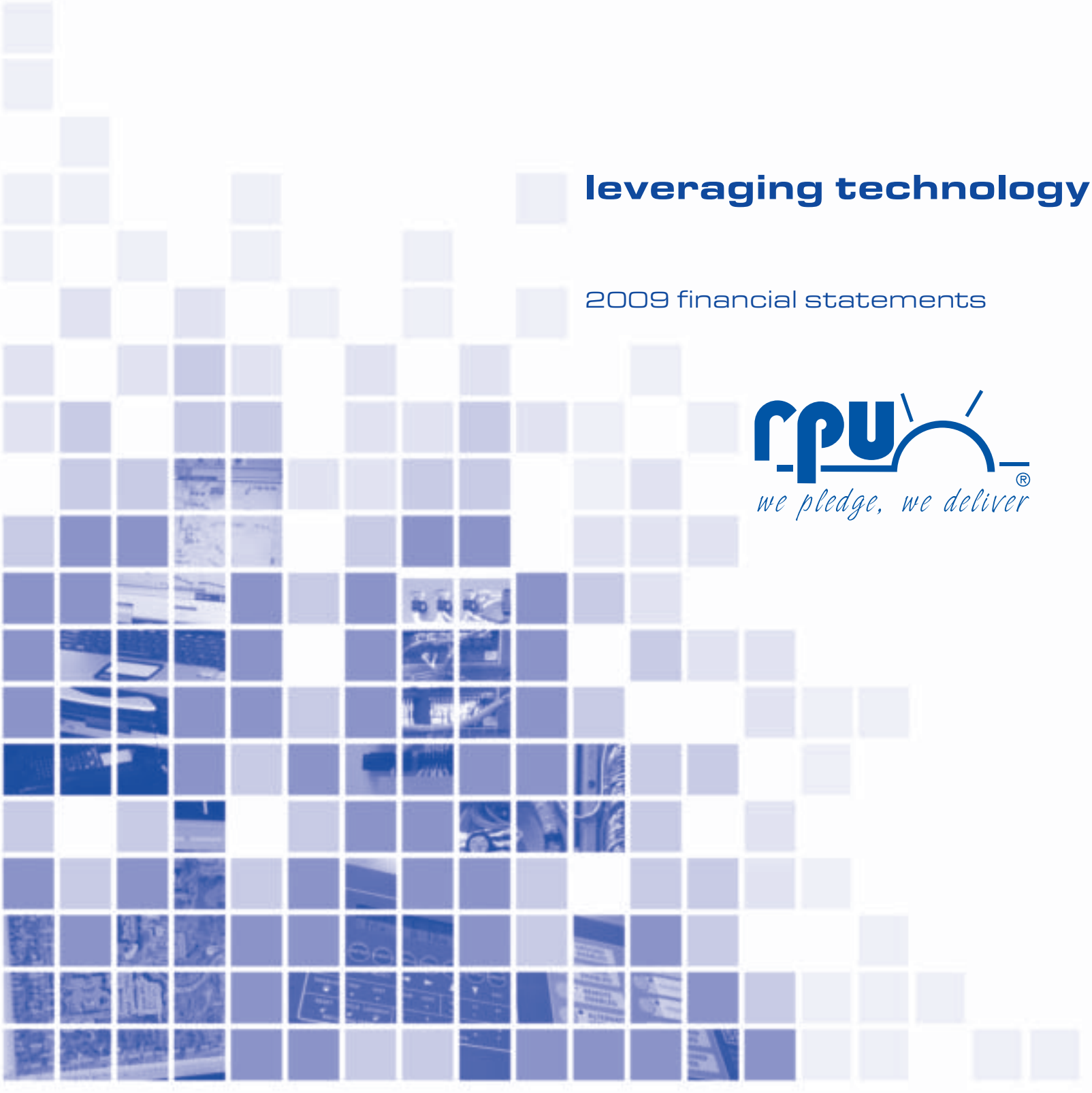
2009 financial statements



Management Discussion & Analysis

The following discussion and analysis of the financial results of Rochester Public Utilities (RPU or the Utility) provides an overview of the utility's financial activities for the year ended December 31, 2009. This discussion is designed to be used in conjunction with the financial statements and notes, which follow this section.

Rochester Public Utilities is a municipal utility governed by a five-member board under the authority of the Rochester City Council. Rochester Public Utilities is comprised of two separate utilities, the Electric Utility and the Water Utility.

Overview of the Financial Statements

Consolidated Financial Statements

The Consolidated Statements of Net Assets present the Utility's assets and liabilities, with the difference between the two reported as net assets. The Statement of Net Assets provides information about the nature and amount of investments in resources (assets), and the obligations to creditors (liabilities). Net assets increase when revenues exceed expenses. The Consolidated Statements of Revenues, Expenses, and Changes in Net Assets report the revenues and expenses during the periods indicated. The Consolidated Statements of Cash Flows provide information about the Utility's cash receipts and payments from operations, as well as funds provided and used in investing and financing activities.

Notes to Consolidated Financial Statements

The notes to consolidated financial statements provide additional information that is essential to a full understanding of the amounts provided in the consolidated financial statements.

HIGHLIGHTS

- Despite national economic conditions, Rochester continued to grow, with 268 new electric customers and 319 new water customers being added in 2009. Growth, however, was lower than the recent past.

- The cooler summer weather had a small impact on revenues and demand decreased slightly due to the cooler weather patterns. Retail kilowatt-hour sales decreased 5.4% from 2008. The annual peak demand of 261.0 megawatts was set in June, which is lower by 3.5% from the demand of 270.4 megawatts set in July 2008. The previous record of 288.3 megawatts was set in July 2006.

- Retail water sales (ccf) were down 3% in 2009 due in part to cooler summer temperatures.

- A 5% rate increase for the Electric Utility was approved by the Utility Board in December 2008, and went into effect January 2009. Water Utility rates were not changed.

- Rates for power purchased from SMMPA (Southern Minnesota Municipal Power Agency) increased 6% in January 2009. Purchased power costs from SMMPA and the MISO market represented 67% of electric operating expenses for 2009.

- The electric utility transferred approximately $8.2 million, and the water utility transferred $360,000 to the City's general fund in the form of in-lieu-of-tax payments.

- A cost-of-service/rate design study was completed for the water utility in 2009, the purpose of which was to determine if any changes to the rate structure were necessary and to assist with the design of water conservation rates as required by Minnesota Statute. Utility staff has designed the new rate structure and are planning to implement it in 2010.

- During 2009, RPU implemented an upgrade to its financial software and customer care system provided through SAP. After several months of process documentation and rigorous testing, the upgrade was successfully completed in October.

- In 2009, RPU implemented a new budget process that incorporates forecasting results twice a year, once in May and again in August. The forecast includes scenario planning for worst, likely and best cases. Through this process, management has been able to monitor expenses more closely and identify cost-saving measures. Because of the approximately $11.6 million cost reduction measures implemented in 2009 and continuing into 2010, including deferral of non-critical projects, there was no rate increase in either utility for 2010.

- In September 2009, the Utility Board and City Council authorized borrowing $6.79 million through the Minnesota Consortium of Municipal Utilities at a variable interest rate. This money will be used by the Electric Utility in 2009 and 2010 to expand the distribution and transmission systems.

- In 2009, the City of Rochester was awarded $1,034,000 through the Energy Efficiency and Conservation Block Grant program. Of this amount, RPU received $403,000 to fund an energy audit for the service center, a street light replacement project and street light study, and five well motor replacements and installation of variable frequency drives at ten well locations.

- In the summer of 2006, a contract was awarded and engineering began on installing emissions control equipment at the Silver Lake Plant. Construction was fully completed on June 1st and testing of the equipment was completed in July. The new equipment will improve air quality by reducing harmful emissions such as sulfur dioxide, nitrogen oxides, and particulate matter.

- Starting in April of 2009, Silver Lake Plant staff developed a method to run certain boilers at Silver Lake without running attached turbines. This allowed RPU to meet Mayo steam demand without forcing uneconomical power into a soft market caused by depressed electric loads. In 2009 alone, the utility saved $1,064,000 from this method of operation, and continues to save in 2010.

- RPU continues to sell energy from the Silver Lake Plant and the Cascade Creek gas turbine into the MISO (Midwest Independent System Operators) market, as well as purchase power through the MISO market for all power needs above the Contract Rate of Delivery limit of 216 megawatts provided by SMMPA.

- RPU continues to be involved in Capacity Expansion by 2020, or the CapX 2020 project. Specifically, RPU is involved with four other utilities, Xcel Energy, Dairyland Power Cooperative, SMMPA, and Wisconsin Public Power Inc., in the future construction of a 345-kilovolt transmission line coming from the Twin Cities down to Rochester, and over to LaCrosse.

- RPU surpassed its Aggressive Demand-Side Management (DSM) goal for 2009 of 16,274 megawatt hours in energy savings. Actual energy savings of 16,994 megawatt hours were achieved through helping commercial and residential customers install energy efficient equipment and technologies. This represents an estimated 16,994 tons of carbon reduction.

- Legislative changes in 2007 affecting the Utility included the Next Generation Energy Act of 2007. To that end, an energy savings goal of 1.5% of annual retail energy sales was set for all Minnesota utilities to reach by 2010. For 2009, RPU's energy savings of 16,994 megawatt hours represented 1.4% of annual retail energy sales.

Financial Analysis – Electric Utility

The following discussion provides analysis of the 2009 and 2008 comparative financial information provided in the following table.

Condensed Financial Information - Electric Utility

December 31, 2009 and 2008
(In millions)

Statement of Revenues, Expenses, & Changes in Net Assets

	2009	2008	Change
Operating Revenues	$ 136.1	$ 147.5	$ (11.4)
Operating Expenses	120.3	129.1	(8.8)
Operating Income	15.8	18.4	(2.6)
Transfers Out (In-Lieu-Of-Tax Payments)	(8.2)	(8.4)	0.2
Other Income & Expense	0.3	2.4	(2.1)
Interest Expense	(4.1)	(4.8)	0.7
Nonoperating Revenue (Expense)	(12.0)	(10.8)	(1.2)
Change in Net Assets	3.8	7.6	(3.8)
Net Assets - Beginning of Year	141.1	133.5	7.6
Net Assets - End of Year	**$ 144.9**	**$ 141.1**	**$ 3.8**

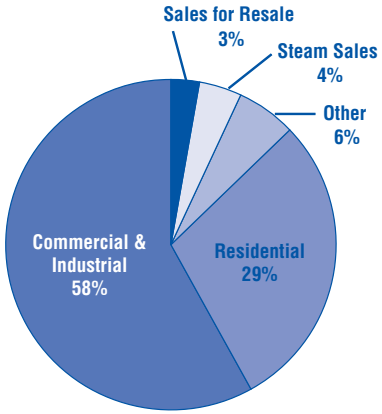
Statement of Net Assets

	2009	2008	Change
Cash and Investments	$ 37.9	$ 27.0	$ 10.9
Other Current Assets	22.9	27.0	(4.1)
Capital Assets, Net	185.7	180.8	4.9
Other Noncurrent Assets	10.0	14.7	(4.7)
Total Assets	256.5	249.5	7.0
Current Liabilities	18.7	18.2	0.5
Long-Term Debt	90.8	88.1	2.7
Other Long-Term Liabilities	2.1	2.1	–
Total Liabilities	111.6	108.4	3.2
Invested in Capital Assets, Net of Related Debt	96.1	94.4	1.7
Restricted	3.7	9.0	(5.3)
Unrestricted	45.1	37.7	7.4
Net Assets	**$ 144.9**	**$ 141.1**	**$ 3.8**

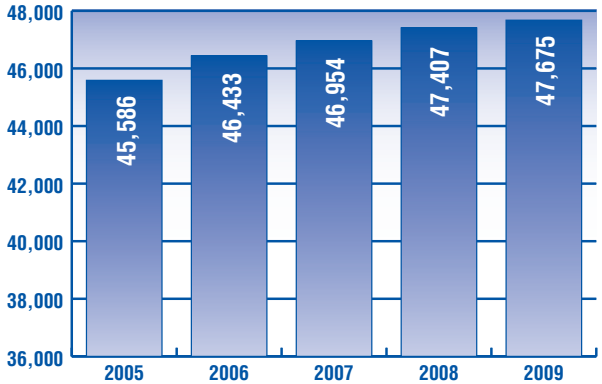
Operating Revenues

Operating revenues decreased $11.4 million (7.7%) in 2009. This was due to a decrease in retail kilowatt-hour sales of 5.4% and a decrease in wholesale revenues of 76%. The decrease in kilowatt-hour sales is offset by a rate increase of 5% that went into effect in January 2009.

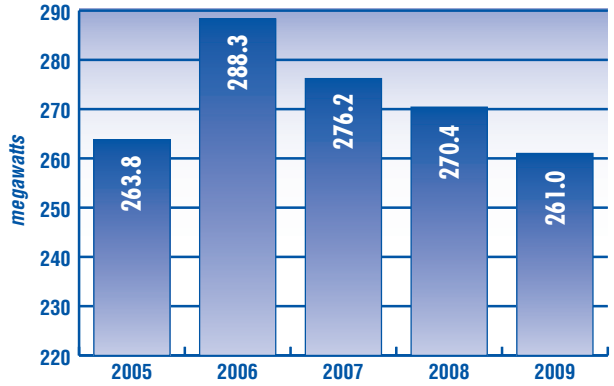
Electric Operating Revenues



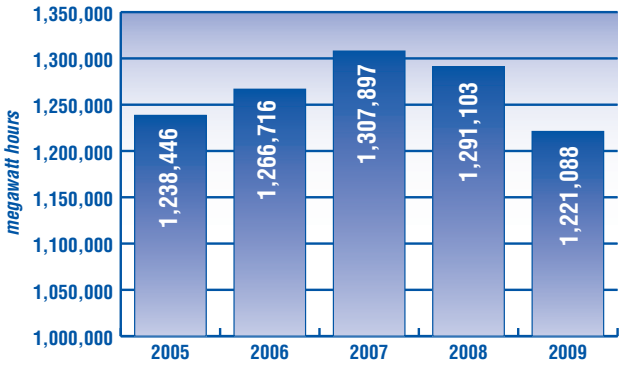
Number of Electric Customers



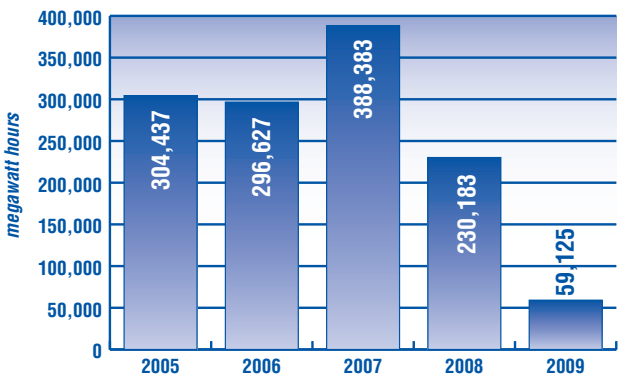
Electric Peaks



Electric Retail Sales



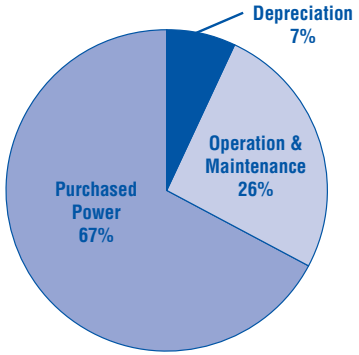
Wholesale Sales



Operating Expenses

Operating expenses decreased $8.8 million (6.8%) in 2009, due primarily to a decrease in generation fuel costs, as well as cost-saving measures implemented in 2009. The primary driver of operating expenses for the Electric Utility continues to be purchases of power from SMMPA and from the MISO market, which comprised 67% of total operating expenses.

Electric Operating Expenses



In-Lieu-of-Tax Payments

The Electric Utility transfers an amount to the City of Rochester's General Fund each month based on the amount of retail kilowatt-hours sold. Due to a decrease in kilowatt-hour sales the payment to the City decreased by $149,000.

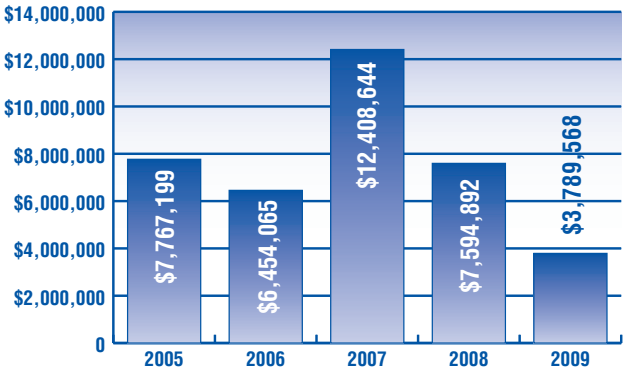
Other Income and Expense

Other income decreased $2.1 million (88%) in 2009. This was due to a decrease in interest revenue earned on the proceeds from revenue bonds issued in March 2007. Interest rates were low during 2009 and the balance of cash in the construction fund was completely drawn down in May due to the completion of the emission reduction project. The proceeds from the new borrowing in September 2009 increased the cash balance, but no interest was earned on these funds in 2009.

Change in Net Assets

The increase in net assets for 2009 was $3.8 million, $3.8 million (50.0%) less than in 2008. This is primarily due to a decrease in retail kilowatt-hour sales and wholesale revenues, offset by a 5% rate increase in January 2009 and cost-saving measures implemented in 2009.

Change in Net Assets

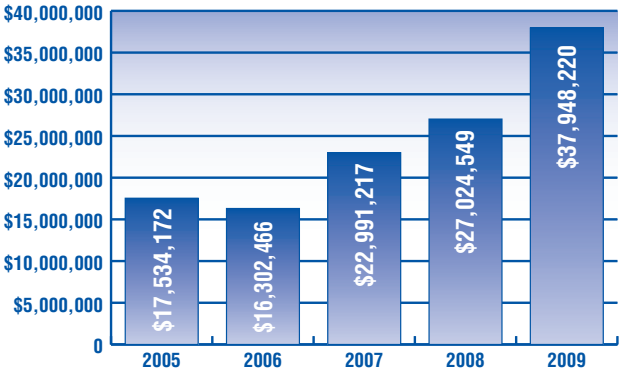


Cash, Investments and Other Assets

The ending unrestricted cash and investments balance for 2009 was $37.9 million, $10.9 million higher than 2008. This is primarily due to the reimbursement of capital expenditures from the 2007 bond issue proceeds as well as proceeds from a note issued in 2009.

In 2005, the Utility Board revised the Financial Liquidity policy to address business risks and better position RPU for the future. Four cash reserve components were established along with guidelines for the calculation of cash reserve targets. Each year as the budget is finalized, revised projections are made for the subsequent four years, and new cash reserve targets are developed based on the board-policy guidelines. It is management's goal that actual cash reserves will be at 95% of the board-policy cash reserve target by the end of 2010. At the end of 2009, actual cash reserves have surpassed that goal by 14.1%.

Unrestricted Cash and Investments – Electric



Other current assets for 2009 were $22.9 million, $4.1 million lower than at the end of 2008. This decrease was due primarily to a decrease in fuels inventory. Because of the depressed wholesale market, wholesale sales have reduced significantly, resulting in a higher coal inventory than anticipated. This has eliminated the need for additional coal purchases, and instead RPU has been able to draw down its' coal inventory for sales into the wholesale market.

Other noncurrent assets decreased by $4.7 million in 2009. Proceeds from the revenue bond issue in March 2007, classified as restricted cash, were fully drawn down in 2009. This decrease was partially offset by the unspent proceeds from the new note borrowing remaining at the end of 2009. These funds were used for the emissions reduction project and other transmission and substation related projects.

Liabilities

Current liabilities increased $0.5 million in 2009, primarily due to an increase in deferred credits. The money received from the Energy Efficiency and Conservation Block Grant program was classified as a restricted asset and a deferred credit, which will be reduced as the money is spent on the projects it is intended for.

Net Assets

Net assets invested in capital assets, net of related debt, increased $1.7 million. This increase reflects additions to capital assets funded through rate-based revenues, fees from customers, and debt proceeds.

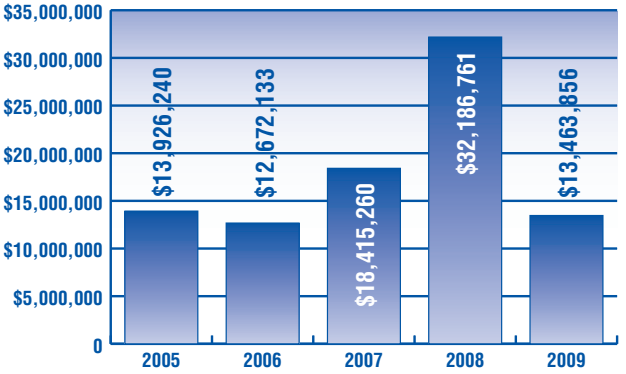
Restricted net assets decreased by $5.3 million. This represents resources that are subject to external restrictions, such as bond covenants or third-party contractual agreements. Specifically, restricted net assets for the Electric Utility consist of cash restricted for bonded projects. See Note 4 to the financial statements for additional details regarding this amount.

Unrestricted net assets are not subject to any constraints by debt covenants or other legal requirements. In 2009, unrestricted net assets increased $7.4 million due to the results of operations.

CAPITAL ASSETS

At December 31, 2009, the Electric Utility had $185.7 million invested in a broad range of utility capital assets, including a coal-burning steam generation plant, two gas turbines, a hydroelectric power generation plant, two diesel generators, equipment related to providing Mayo Clinic's Prospect Plant with steam, emission reduction equipment, electric transmission and distribution lines, buildings and equipment. Capital assets increased $10.7 million in 2009, reflecting the installation of structures and equipment designed to reduce harmful emissions from the Silver Lake Plant, investments in the distribution and transmission systems, and general facilities of the Electric Utility. This increase in capital assets was partially offset by a $5.8 million increase in accumulated depreciation. Additional details regarding the Utility's total assets (electric and water) may be found in Note 5 to the financial statements. Capital and major maintenance expenses decreased by $18.7 million in 2009, due to the completion of the emission reduction project and a lower dollar amount budgeted for capital projects in 2009.

Capital and Major Maintenance Expenditures



LONG-TERM DEBT

At the end of 2009, the Utility had $83.5 million in revenue bonds and $10.2 million in revenue notes outstanding. In September 2009, the Utility Board authorized borrowing approximately $6.8 million (the revenue note) through the Minnesota Consortium of Municipal Utilities at a variable interest rate. The closing on this loan occurred in September 2009. This money was partially used in 2009, and the remainder will be spent in 2010 by the Electric Utility on transmission, distribution, and substation capital projects. In addition to this new revenue note, $2.5 million was retired in 2009.

The Utility was upgraded to an AA- bond rating from Fitch in 2007, and maintained an Aa2 bond rating from Moody's on its revenue bonds. Additional details regarding the Utility's long-term debt may be found in Note 6 to the financial statements.

Financial Analysis – Water Utility

The following discussion provides analysis of the 2009 and 2008 comparative financial information provided in the following table.

Condensed Financial Information - Water Utility

December 31, 2009 and 2008

(In millions)

Statement of Revenues, Expenses, & Changes in Net Assets

	2009	2008	Change
Operating Revenues	$ 8.2	$ 8.2	$ –
Operating Expenses	7.2	7.0	0.2
Operating Income	1.0	1.2	(0.2)
Transfers Out (In-Lieu-Of-Tax Payments)	(0.4)	(0.4)	–
Other Income & Expense	–	0.2	(0.2)
Interest Expense	–	(0.1)	0.1
Capital Contributions	2.6	1.1	1.5
Nonoperating Revenue (Expense)	2.2	0.8	1.4
Change in Net Assets	3.2	2.0	1.2
Net Assets - Beginning of Year	84.8	82.8	2.0
Net Assets - End of Year	**$ 88.0**	**$ 84.8**	**$ 3.2**

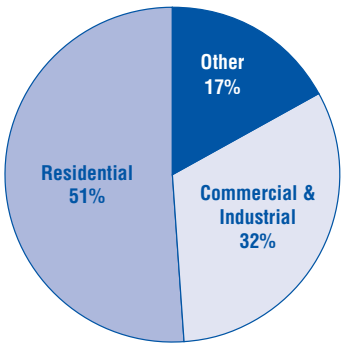
Statement of Net Assets

	2009	2008	Change
Cash and Investments	$ 5.9	$ 5.3	$ 0.6
Other Current Assets	0.5	0.5	–
Capital Assets, Net	83.1	81.1	2.0
Total Assets	89.5	86.9	2.6
Current Liabilities	1.3	1.6	(0.3)
Long-Term Debt	–	0.4	(0.4)
Other Long-Term Liabilities	0.2	0.1	0.1
Total Liabilities	1.5	2.1	(0.6)
Invested in Capital Assets, Net of Related Debt	82.6	80.3	2.3
Unrestricted	5.4	4.5	0.9
Net Assets	**$ 88.0**	**$ 84.8**	**$ 3.2**

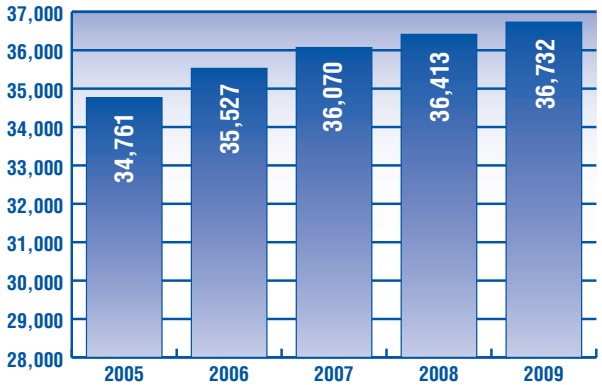
Operating Revenues

Operating revenues were unchanged in 2009. Rates from 2008 were not changed. Although sales volume decreased by 3%, utility service revenues decreased by only 1%. This is due to the rate structure where approximately 45% of utility service revenue comes from a fixed customer charge that doesn't vary with sales volume. The reduction in revenue related to sales volume was partially offset by an increase of $102,000 (15%) in other operating revenue.

Water Operating Revenues



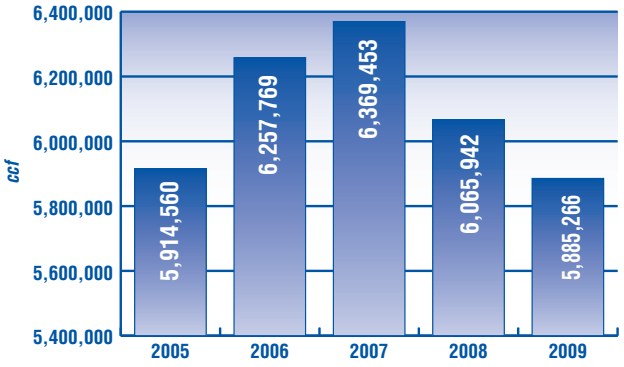
Number of Water Customers



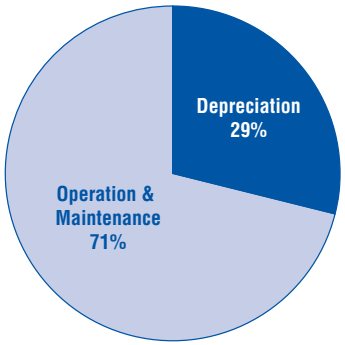
Operating Expenses

Operating expenses increased by $204,000 (2.9%) in 2009. This was primarily due to increases in salaries and electric services used by the water utility, partially offset by a decrease in materials and supplies.

Water Retail Sales



Water Operating Expenses



In-Lieu-of-Tax Payments

The Water Utility transfers an amount to the City of Rochester's General Fund each month based on the amount of retail ccf (hundred cubic feet) sold. Due to the decrease in ccf sold in 2009, payments to the City decreased by approximately $14,000.

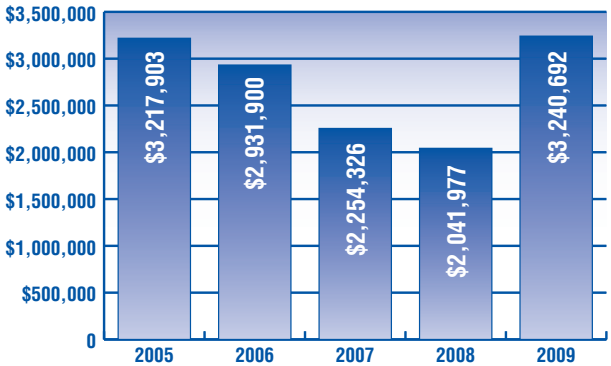
Capital Contributions

Capital contributions increased $1.5 million in 2009. These are assets, primarily water mains and fire hydrants, which are contributed to the Water Utility from both the City and developers. These assets are valued using a costing database that estimates the approximate construction costs associated with these assets.

Change in Net Assets

The increase in net assets for 2009 was $3.2 million, $1.2 million higher than in 2008. This is primarily due to the increase in reported capital contributions in 2009.

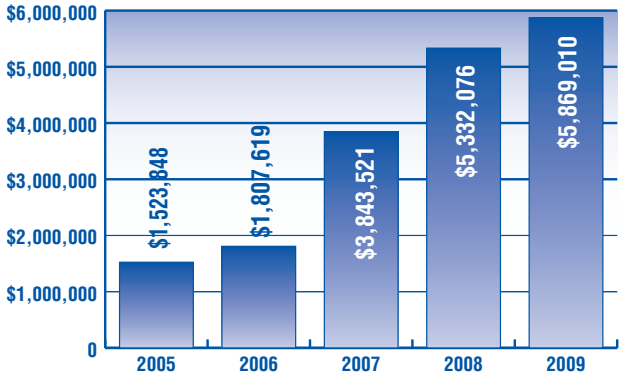
Change in Net Assets



Cash, Investments and Other Assets

The ending unrestricted cash and investments balance for 2009 was $5.9 million, $0.6 million higher than 2008 due to an increased amount of cash provided by operations and lower than anticipated capital expenditures.

Unrestricted Cash and Investments – Water



Other current assets for 2009 were $522,000. These consisted of accounts receivable and inventory.

Liabilities

Current liabilities decreased $0.3 million in 2009 due to a smaller amount owed to the City at the end of 2009 as well as a decrease in accounts payable.

Net Assets

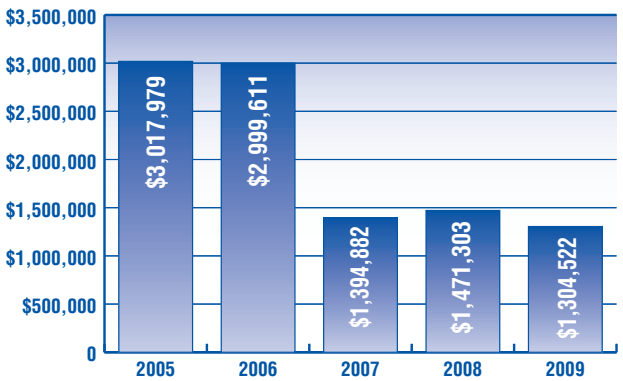
Net assets invested in capital assets, net of related debt, increased $2.3 million. This increase reflects additions to capital assets. Capital expenditures for the Water Utility are funded through rate-based revenues, fees from customers and debt proceeds.

Unrestricted net assets are not subject to any constraints established by debt covenants or other legal requirements. In 2009, unrestricted net assets increased $0.9 million due to the results of operations.

CAPITAL ASSETS

At December 31, 2009, the Water Utility had $83.1 million invested in a broad range of utility capital assets, including 19 water storage facilities, 31 wells, water mains, pump station facilities, buildings, and equipment. Capital assets increased $3.9 million in 2009, reflecting capital contributions as well as construction associated with the growth of the City and general facilities of the Water Utility. This increase in capital assets was partially offset by a $2.0 million increase in accumulated depreciation. Additional details regarding the Utility's total assets (electric and water) may be found in Note 5 to the financial statements. Capital and major maintenance expenses decreased by $167,000 in 2009, due to a smaller amount budgeted for capital projects in 2009. Some of the major components of capital spending in 2009 were City and developer projects, new wells, water storage facility maintenance, well maintenance and spending on water meters and automated meter reading.

Capital and Major Maintenance Expenditures



LONG-TERM DEBT

At the end of 2009, the Utility had a $410,000 revenue note outstanding. No new debt was issued during the year, and $390,000 was retired in 2009.

Miscellaneous Information

ECONOMIC FACTORS

The City Council has approved Electric and Water rate increases as needed to support the utility on a cost of service basis. In December 2008, the Electric Utility had a 5.0% increase approved that went into effective in January, 2009. The Water Utility has had 5.0% increases each year in 2005, 2006 and 2007. These overall increases will help strengthen RPU's financial stability by meeting the expected increased costs to operate each Utility, improve system reliability, and build liquidity by increasing cash reserves. The table below compares historical electric and water rate increases with the annual inflation rate, as well as an average for the last ten years.

Year	Inflation	Electric Rates	Water Rates
2010*	2.5%	0.0%	0.0%
2009*	0.2%	5.0%	0.0%
2008	3.9%	4.0%	0.0%
2007	2.8%	8.0%	5.0%
2006	3.2%	13.5%	5.0%
2005	3.4%	3.0%	5.0%
2004	2.7%	3.0%	4.0%
2003	2.3%	0.0%	4.0%
2002	1.6%	3.0%	0.0%
2001	2.8%	0.0%	5.0%
Annualized Average	2.5%	3.9%	2.8%

*Estimated Yearly Values

In addition to inflation, management continually plans for and identifies issues or potential contingencies that could impact future rates, such as system expansion, infrastructure needs, accelerated debt payments, future supply costs, regulatory changes, and others. Growth of the city directly affects several of these factors.

With the continued slowdown in the housing market, growth of the city has remained slow as well. In 2009, there were 271 building permits totaling $49.3 million issued for single-family homes as compared to 302 permits totaling $68.8 million in 2008. Commercial building permits numbered 30 for 2009 totaling $28.2 million as compared to 70 commercial permits valued at $74.4 million in 2008.

The December, 2009, unemployment rate for the area of 6.0% remains well below the state and national rates of 7.4% and 10.0%, respectively. The employment data shows that, on average, there were slightly fewer people working in the Rochester area than the previous year. During the past 12 months, the average unemployment rate for Rochester was 6.4%.

After examining all of these factors in the budgeting process, RPU has projected electric rates to increase modestly over the next five years, while water rates are expected to remain steady. However, taking into account the current economic conditions and the effect it has had on customers, management has felt it prudent to avoid an electric rate increase for 2010 if at all possible. RPU management and employees were able to make this possible by devising and implementing several cost-cutting measures for 2009 and 2010.

REQUESTS FOR INFORMATION

The consolidated financial statements, notes, and management discussion and analysis are designed to provide a general overview of RPU's finances. Questions concerning any of the information provided in this report should be directed to RPU at 4000 E River Rd NE, Rochester, MN 55906. The phone number is (507) 280-1500. Additional information regarding RPU may also be found on its website at www.rpu.org.

Consolidated Statements of Revenues, Expenses, and Changes in Net Assets

	Years Ended December 31	
	2009	2008
Operating Revenues:		
Electric:		
Retail	**$120,959,880**	$119,169,267
Wholesale	**4,507,199**	19,130,151
Other	**10,682,359**	9,162,749
Water	**8,192,390**	8,174,118
Total Operating Revenues	**144,341,828**	155,636,285
Operating Expenses:		
Purchased Power	**81,138,926**	79,934,588
Operations and Maintenance	**36,075,061**	46,202,217
Depreciation	**10,331,042**	9,919,462
Total Operating Expenses	**127,545,029**	136,056,267
Operating Income	**16,796,799**	19,580,018
Nonoperating Income (Expenses):		
Investment Income	**1,102,545**	2,821,942
Interest Expense	**(4,073,070)**	(4,775,846)
Miscellaneous, Net	**(789,030)**	(317,256)
Total Nonoperating Income (Expenses)	**(3,759,555)**	(2,271,160)
Income Before Transfers/Capital Contributions	**13,037,244**	17,308,858
Transfers Out	**(8,601,990)**	(8,765,487)
Capital Contributions	**2,595,007**	1,093,498
Change in Net Assets	**7,030,261**	9,636,869
Net Assets, Beginning of Year	**225,959,350**	216,322,481
Net Assets, End of Year	**$232,989,611**	$225,959,350

See Notes to Consolidated Financial Statements Found on Pages 39-43

Income by Segments of Business

2009	Electric	Water	Total
Operating Revenues:			
Retail	**$120,959,880**	**$7,424,541**	**$128,384,421**
Wholesale	**4,507,199**	**–**	**4,507,199**
Other	**10,682,359**	**767,849**	**11,450,208**
Total Operating Revenues	**136,149,438**	**8,192,390**	**144,341,828**
Operating Expenses	**120,356,118**	**7,188,911**	**127,545,029**
Operating Income	**15,793,320**	**1,003,479**	**16,796,799**
Nonoperating Income (Expense)	**(3,761,411)**	**1,856**	**(3,759,555)**
Income Before Transfers/Capital Contributions	**12,031,909**	**1,005,335**	**13,037,244**
Transfers Out	**(8,242,341)**	**(359,649)**	**(8,601,990)**
Capital Contributions	**–**	**2,595,007**	**2,595,007**
Change in Net Assets	**$3,789,568**	**$3,240,693**	**$7,030,261**

2008	Electric	Water	Total
Operating Revenues:			
Retail	$119,169,267	$7,507,855	$126,677,122
Wholesale	19,130,151	–	19,130,151
Other	9,162,749	666,263	9,829,012
Total Operating Revenues	147,462,167	8,174,118	155,636,285
Operating Expenses	129,070,920	6,985,347	136,056,267
Operating Income	18,391,247	1,188,771	19,580,018
Nonoperating Income (Expense)	(2,407,620)	136,460	(2,271,160)
Income Before Transfers/Capital Contributions	15,983,627	1,325,231	17,308,858
Transfers Out	(8,391,442)	(374,045)	(8,765,487)
Capital Contributions	2,707	1,090,791	1,093,498
Change in Net Assets	$7,594,892	$2,041,977	$9,636,869

See Notes to Consolidated Financial Statements Found on Pages 39-43

Consolidated Statements of Net Assets

	December 31	
	2009	2008
ASSETS:		
Current Assets:		
Cash and Cash Equivalents (Note 3)	**$9,336,817**	$32,356,638
Investments	**34,480,414**	–
Accounts Receivable and Accrued Utility Revenues	**11,429,192**	11,303,006
Fossil Fuel Inventory	**6,568,850**	10,676,370
Materials and Supplies Inventory	**5,208,667**	5,281,959
Other Current Assets	**180,726**	247,366
Total Current Assets	**67,204,666**	59,865,339
Non-Current Assets:		
Restricted Assets (Note 4):		
Cash and Cash Equivalents	**8,617,926**	13,240,843
Deferred Charges:		
Unamortized Bond Issuance Costs	**807,539**	806,241
Other	**590,095**	592,028
Total Deferred Charges	**1,397,634**	1,398,269
Capital Assets:		
Construction Work in Progress	**21,697,174**	49,772,624
Land and Land Rights	**3,220,729**	3,175,326
Depreciable Assets, Net (Note 5):		
Electric	**167,000,694**	132,448,567
Water	**76,946,857**	76,561,617
Net Capital Assets	**268,865,454**	261,958,134
Total Non-Current Assets	**278,881,014**	276,597,246
Total Assets	**$346,085,680**	$336,462,585

See Notes to Consolidated Financial Statements Found on Pages 39-43

	December 31	
	2009	2008
LIABILITIES:		
Current Liabilities:		
Accounts Payable	**$10,443,091**	$12,129,603
Due to Other Funds	**1,666,813**	1,804,014
Accrued Compensation and Compensated Absences	**2,252,398**	2,013,728
Customer Deposits	**453,957**	347,816
Interest Payable	**316,813**	323,771
Current Maturities of Long Term Debt (Note 6)	**4,268,252**	2,897,352
Deferred Credits	**603,751**	255,821
Total Current Liabilities	**20,005,075**	19,772,105
Non-Current Liabilities:		
Accrued Compensated Absences	**1,530,771**	1,377,518
Accrued Claims	**49,000**	93,000
Long-Term Debt (Note 6)	**90,773,008**	88,485,977
Unearned Lease Revenues	**738,215**	774,635
Total Non-Current Liabilities	**93,090,994**	90,731,130
Commitments and Contingencies (Note 10)		
Total Liabilities	**$113,096,069**	$110,503,235
NET ASSETS:		
Invested in Capital Assets, Net of Related Debt	**$178,790,823**	$174,855,537
Restricted for Construction (Note 4)	**3,651,298**	8,960,112
Unrestricted Net Assets	**50,547,490**	42,143,701
Total Net Assets	**$232,989,611**	$225,959,350

See Notes to Consolidated Financial Statements Found on Pages 39-43

Consolidated Statements of Cash Flows

	Years Ended December 31	
	2009	2008
Cash Flows From Operating Activities:		
Cash Received from Customers	**$140,386,871**	$152,653,050
Cash Paid to Suppliers and Employees	**(111,805,352)**	(131,403,000)
Internal Activity – Payments From Other Funds	**5,197,110**	5,140,516
Net Cash Provided By Operating Activities	**33,778,629**	26,390,566
Cash Flows From Noncapital Financing Activities:		
Operating Transfers to Other Funds	**(8,619,111)**	(8,727,583)
Cash Flows From Capital and Related Financing Activities:		
Capital Contributions	**–**	2,708
Additions to Utility Plant and Other Assets	**(17,700,992)**	(31,910,067)
Service Territory Acquisition	**(1,275,192)**	(1,147,781)
Payments on Bonds and Notes Payable Obligations	**(7,261,442)**	(6,963,688)
Proceeds from Issuance of Notes Payable	**6,790,000**	–
Net Cash (Used In) Capital and Related Financing Activities	**(19,447,626)**	(40,018,828)
Cash Flows From Investing Activities:		
Interest Received	**1,125,784**	2,801,103
Increase in Investments	**(34,480,414)**	–
Funds Released From Service Territory Escrow	**–**	2,188,886
Service Territory Escrow Payments	**–**	(56,301)
Net Cash Provided By (Used In) Investing Activities	**(33,354,630)**	4,933,688
Net Increase (Decrease) in Cash and Cash Equivalents	**(27,642,738)**	(17,422,157)
Cash and Cash Equivalents, Beginning of Year	**45,597,481**	63,019,638
Cash and Cash Equivalents, End of Year	**17,954,743**	45,597,481
Classified As:		
Current Assets	**$9,336,817**	$32,356,638
Restricted Assets	**8,617,926**	13,240,843
Total Cash and Cash Equivalents, End of Year	**$17,954,743**	$45,597,481
Reconciliation of Operating Income to Net Cash Provided by Operating Activities:		
Operating Income	**$16,796,799**	$19,580,018
Adjustments to Reconcile Operating Income to Net Cash Provided by Operating Activities:		
Depreciation	**10,331,042**	9,919,462
Bad Debts	**478,228**	681,890
Other	**(740,886)**	(828,129)
(Increase) Decrease In:		
Accounts Receivable and Accrued Utility Revenues	**(604,415)**	2,013,579
Inventories	**4,180,812**	(3,132,054)
Prepaid and Other Current Assets	**43,778**	(141,233)
Increase (Decrease) In:		
Accrued Liabilities and Accounts Payable	**2,875,620**	(1,503,503)
Customer Deposits	**106,141**	(138,398)
Unearned Lease Revenues	**(36,420)**	(36,420)
Other	**347,930**	(24,646)
Net Cash Provided by Operating Activities	**$33,778,629**	$26,390,566
Non-Cash Capital and Related Financing Activities:		
Additions to Utility Plant and Other Assets Contributed By:		
City's Governmental Funds	**$2,452,751**	$311,646
Developers	**$142,256**	$779,145
Equipment Purchases in Accounts Payable	**$907,928**	$5,242,216

See Notes to Consolidated Financial Statements Found on Pages 39-43

Notes to Consolidated Financial Statements

NOTE 1: Organization and Summary of Significant Accounting Policies

Organization and Accounting Method
Rochester Public Utilities ("Utility") is a municipal utility. The Electric Utility is engaged in the generation, transmission, and distribution of electric power and energy, and related activities. The Water Utility is engaged in the supply, purification, and distribution of water, and related activities. The equity of the Utility is vested in the City of Rochester, Minnesota. The Utility is comprised of two proprietary funds, the Electric and the Water Enterprise Funds of the City of Rochester, Minnesota. Activities are accounted for using the flow of economic resources measurement focus and the accrual basis of accounting. The Utility prepares its financial statements as a proprietary fund in conformity with the applicable pronouncements of the Governmental Accounting Standards Board (GASB). Pursuant to GASB Statement No. 20, the Utility has elected to apply the provisions of all relevant pronouncements of the Financial Accounting Standards Board (FASB) that were issued on or before November 30, 1989, to the extent they do not conflict with or contradict GASB pronouncements. Interfund transactions are not eliminated for purposes of the consolidated financial statements.

Operating Revenues
Meters are read through a series of monthly cycles. Accounts are billed based on a combination of fixed charges and charges for actual usage. Utility tariffs for electric service include a power supply adjustment under which electric rates charged to customers are adjusted to reflect changes in power supply costs. Other activities are billed according to contractual arrangements and fees, or fees for services provided. Utility revenues are recognized on the accrual basis of accounting and include estimated amounts for service rendered but not billed.

Accounts Receivable
The Utility provides an allowance for losses on receivables, as needed, for accounts considered uncollectible.

Capital Assets, Depreciation and Amortization
Electric and water capital assets are recorded at original cost. Additions to utility plant and significant replacements are recorded at cost. Cost includes components of labor, materials and overhead. Depreciation expense is recorded using the straight-line method over the expected useful life of the asset, which ranges from five years to seventy-five years. Purchased service territory rights are amortized over a forty-year period on a straight-line basis.

Contributions in Lieu of Taxes
Contributions in Lieu of Taxes are paid by the Utility to the General Fund of the City of Rochester based upon the monthly commodity sales billed by the electric and water utilities, and are reported as Transfers Out in the Statement of Revenues, Expenses and Changes in Net Assets.

Inventories
Inventories consist of materials, supplies, and fossil fuels used in Utility operations. Materials and supplies inventory is valued at the lower of moving average cost or market. Fossil fuel inventory is valued at cost, using the last-in, first-out method.

Compensated Absence Benefits
Vacation pay, which is payable upon termination, is accrued as it is earned by employees.

The Utility's sick leave liability is estimated based on the Utility's past experience of making termination payments for sick leave. Employees are compensated upon termination for forty percent of their unused sick leave, after meeting certain qualifications.

Amortization of Bond Issuance Costs and Bond Discount/Premium
Bond issuance costs, bond discounts and bond premiums are amortized over the terms of the related bond issues using the interest method.

Taxes
In accordance with certain provisions of the United States Internal Revenue Code and related federal and state governing laws and regulations, the Utility is exempt from federal and state income taxes, and local property taxes.

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

Reclassifications
Certain reclassifications have been made to the 2008 financial statements to conform to the 2009 presentation.

Concentration of Credit Risk
Financial instruments which expose the Utility to a concentration of credit risk consist primarily of cash equivalents and accounts receivable.

Cash equivalents and investments are primarily comprised of a portion of the Utility's equity in the City of Rochester cash and investment pool. Credit risk factors associated with the cash and investment pool are disclosed in Note 3.

The Utility's accounts receivable are generally due from a large number of residential and business retail customers who are concentrated geographically in or near the City of Rochester.

NOTE 2: Revenues

Revenue, consisting primarily of billings to customers for Utility services, includes accrued Utility revenue amounts of $3,574,482 and $3,060,872 for the years ended December 31, 2009 and 2008, respectively.

Sales to the Utilities single largest retail customer were $15,717,401 and $17,702,020 in 2009 and 2008, respectively. During the year ended December 31, 2009, no other customer accounted for more than 10% of operating revenues. Sales to other funds of the City of Rochester were $4,945,851 and $4,287,970 for the years ended December 31, 2009 and 2008, respectively.

NOTE 3: Cash and Cash Equivalents

The Utility considers all temporary cash investments, including the Utility's equity in the cash portion of the City of Rochester investment pool, to be cash and cash equivalents. Generally, cash equivalents are highly liquid investments.

All deposits are insured or collateralized by securities held by the City of Rochester or its agents in the City's name.

The Utility's equity in the City of Rochester cash and investment pool is based on actual cash receipts and disbursements and a monthly allocation of investment earnings on a pro-rata basis. Investments held in the investment pool are disclosed in the notes to the City of Rochester's basic financial statements included in the City's 2009 Comprehensive Annual Financial Report.

NOTE 4: Restricted Assets

Restricted Cash and Cash Equivalents
Under the provisions of the 2000A and 2002A revenue bonds, the Electric Utility is required to fund a debt service account in an amount equal to the following year's bond principal and interest payments at least by the date the debt service payments are due each year. In addition to the debt service account, bond provisions require that $4,966,628 of the bond proceeds be deposited in a reserve account to be used to pay bond principal and interest payments if funds in the debt service account are insufficient. Under the provisions of the bond agreements and a revenue note, unspent proceeds are placed in a construction fund until capital expenditures are made.

Restricted Cash and Cash Equivalents are summarized as follows:

	2009	2008
Reserve Account	$ 4,966,628	$ 4,280,731
Construction Fund	3,651,298	8,960,112
Total Restricted Cash and Cash Equivalents	$ 8,617,926	$ 13,240,843

NOTE 5: Capital Assets

Major classes of depreciable assets and total accumulated depreciation as of December 31, 2009 and 2008 are as follows:

	2009	2008
Intangible Plant Assets	$ 10,763,107	$ 10,251,460
Buildings, Structures, and Improvements	43,481,508	34,878,067
Installations, Equipment, and Fixtures	327,092,905	293,518,477
Total Depreciable Assets	381,337,520	338,648,004
Less: Accumulated Depreciation	137,389,969	129,637,820
Net Depreciable Assets	$ 243,947,551	$ 209,010,184

In 2009, capital assets totaling $2,452,751 were contributed to the Utility by other funds of the City of Rochester, and $142,256 were contributed to the Utility by others.

NOTE 6: Long-Term Debt

At December 31, 2009 and 2008, long-term debt consisted of the following:

	2009	2008
Revenue Bonds, Series 2007C 4.00% - 5.00%, due each December 1 through 2030	$ 75,750,000	$ 75,970,000
Revenue Bonds, Series 2002A 3.00% - 4.50%, due each December 1 through 2017	6,910,000	7,620,000
Revenue Bonds, Series 2000A, 4.75% - 5.25%, due each December 1 through 2010	865,000	1,695,000
Revenue Note Payable, principal due each December 1 through 2014, interest due each June 1 and December 1 at variable rate, currently 2.0%	3,615,000	4,140,000
Revenue Note Payable 3.80%, principal due each December 1 through 2010, interest due monthly	410,000	800,000
Revenue Note Payable, principal due each December 1 through 2014, interest due each June 1 and December 1 at variable rate, currently 2.00%	6,590,000	–
Capital lease obligations	228,252	450,604
Less: Unamortized Discount	185,427	197,428
Less: Unamortized Deferred Amount on Refunding	1,788,870	1,926,113
Plus: Unamortized Premium	2,647,305	2,831,266
Less: Current Maturities	4,268,252	2,897,352
Total Long-Term Debt	$ 90,773,008	$ 88,485,977

The revenue bonds and notes are secured by all funds and revenues of the Utility derived from the ownership and operation of its electric and water utility systems. The bond issuance costs, bond discount and bond premium, and deferred amount on refunding are amortized over the terms of the bond issues.

In March 2007, the Electric Utility issued $76.2 million in Revenue Bonds, Series 2007C, to finance the emission reduction project at Silver Lake Plant, transmission and substation work, and distribution system expansion, and to advance refund the majority of the outstanding Series 2000A Bonds. With respect to the refunded portion, net proceeds of $31.7 million (after payment of underwriting fees, insurance, and other issuance costs) were deposited in an irrevocable trust with an escrow agent to provide for all future debt service payments on the refunded portion of the Series 2000A Bonds. As a result, the 2011-2030 maturities of the Series 2000A Bonds are considered to be defeased and the liability for those bonds has been removed from the financial statements.

The advance refunding resulted in a difference between the reacquisition price and net carrying amount of the old debt of $2,172,658. This difference, reported in the financial statements as a deduction from revenue bonds payable, is being amortized and charged to operations over the bond term using the interest method. The unamortized balance at December 31, 2009 and 2008 was $1,788,870 and $1,926,113 respectively. The Utility completed the advance refunding to reduce its total debt service payments over the subsequent 23 years by $3.1 million and to obtain an economic gain (difference between the present values of the old and the new debt service payments) of $2.0 million. At December 31, 2009, $30,165,000 of the Series 2000A revenue bonds outstanding are considered defeased.

The annual requirements to amortize all debt outstanding as of December 31, 2009, including interest payments of $51,593,239 are as follows:

	Revenue Bonds	Notes Payable	Capital Leases
2010	$ 5,632,769	$ 2,584,846	$ 235,065
2011	5,627,681	2,227,803	–
2012	5,631,081	2,281,350	–
2013	5,631,281	2,344,186	–
2014	5,633,281	2,402,135	–
Thereafter	105,730,013	–	–
Total	$ 133,886,106	$11,840,320	$ 235,065

NOTE 7: Southern Minnesota Municipal Power Agency

The Utility is a voting member of the Southern Minnesota Municipal Power Agency (SMMPA). The Utility has entered into a power purchase contract with SMMPA, whereby SMMPA will provide all Utility power requirements up to 216 megawatts, the contract rate of delivery. This contract expires in the year 2030. In 1999, the Utility and SMMPA agreed to a contract rate of delivery (CROD) that began in 2000. The CROD caps the amount of power SMMPA must supply to the Utility under the power purchase contract. The Utility is responsible for acquiring its power needs above the CROD. The Utility purchased 1,233,900,666 and 1,311,328,492 kilowatt hours totaling $80,715,232 and $78,800,735 from SMMPA during the years ended December 31, 2009 and 2008, respectively.

The Utility leases a portion of its electrical transmission system, known as the North Loop, to SMMPA under a non-cancelable operating lease through the year 2030. The Utility is responsible for all operating and maintenance costs. The Utility received a lump sum payment of $1,500,000 in 1989 and lease revenues are being recognized ratably over the lease term.

NOTE 8: Pension Plans

The Utility participates in a statewide retirement plan administered by the Public Employees Retirement Association (PERA) of Minnesota. PERA administers the Public Employees Retirement Fund (PERF) which is a cost sharing, multiple employer retirement plan. PERA provides retirement benefits as well as disability benefits to members and benefits to survivors upon death of eligible members. Benefits and annual contributions are established by State statute. Total required contributions made during the year ended December 31, 2009 were $1,867,212 of which $987,857 was made by the Utility and $879,355 was made by the Utility's employees.

PERA does not make separate measurements of assets and pension benefit obligations for individual employers participating in the plan. PERA issues a publicly available financial report that includes financial statements and required supplementary information for PERF. That report may be obtained by writing to PERA, 60 Empire Dr. # 200, St. Paul, Minnesota, 55103-2088 or by calling (651) 296-7460 or 1-800-652-9026.

The Utility had maintained an unqualified supplemental pension plan. The plan was unfunded and was discontinued in 1968. Funds have been deposited with a plan administrator to fund the estimated benefits due under the plan. The pension reserve deposit as of December 31, 2009 and 2008 was $66,181 and $74,925, respectively.

NOTE 9: Legal Matters

In 2005, the City of Rochester brought a claim against Southern Minnesota Municipal Power Agency (SMMPA) its primary wholesale power supplier, seeking a declaratory judgment that by virtue of the establishment of a "contract rate of delivery (CROD)" in 1999 under Rochester's contract with SMMPA, Rochester is not obligated to pay the capital costs of new generating resources. Rochester also alleged breach of contract related to the process by which SMMPA establishes its rates and the possibility that SMMPA might have overcollected costs through rates charged to RPU (and others) under the Power Sales Contract since 2003. In 2006, Rochester amended and supplemented its claims. With respect to the CROD-related count, Rochester amended the requested judgment to state that SMMPA cannot charge Rochester for the capital costs of generating facilities exceeding the 216 MW CROD. With respect to the breach of contract issues regarding rates, Rochester amended and supplemented the count to argue that SMMPA has not followed correct ratemaking procedures and may have undercollected important costs in past years.

SMMPA filed a counterclaim alleging that RPU's steam sale agreement with the Mayo Clinic breached a 1992 "Settlement Agreement" concerning the use of RPU's Silver Lake Plant. SMMPA also filed counterclaims for declaratory judgment on issues relating to the nature of RPU's obligations under the Power Sales Contract. Early in 2007, SMMPA added a counterclaim requesting a judgment declaring, among other things, that the SMMPA Board has virtually unlimited discretion in setting rates under the Power Sales Contract with Rochester.

A bench trial covering the City of Rochester claim and SMMPA's counter claim was held in January, 2009. Before and during the trial, the Court granted Rochester's motions to dismiss its breach of contract claims concerning rates. On May 8, 2009, the Court issued a decision that denied the requested declaratory judgment, granted portions of SMMPA's counterclaims concerning its rate setting authority but denied the remainder. The decision rejected SMMPA's counterclaim concerning the Settlement Agreement. Rochester filed

a post trial motion to amend the declaratory judgment decision to incorporate specific findings from the decision; SMMPA filed other post trial motions. On March 17, 2010, the Court issued an order accepting certain clerical corrections to the decision, denying Rochester's other motions, granting SMMPA's motion for payment of $252,317 for expert witness fees and denying SMMPA's motion for sanctions. No decisions on possible appeals have been announced. RPU has recorded the order for payment of expert witness fees as a liability in the accompanying financial statements.

NOTE 10: Commitments and Contingencies

Risk Management Program

The City of Rochester has established a self-insurance program for group health coverage and workers' compensation. Rochester Public Utilities participates in this self-insurance program. The group health program is limited to losses of $225,000 per claim with a variable annual aggregate, and the workers' compensation coverage is limited to $860,000 per occurrence, both through the use of stop-loss policies. The City recognizes a liability on individual claims when a loss is probable and the amount can be reasonably estimated. In addition, the City recognizes an estimated liability on unreported claims that are incurred but not yet reported.

Power Sales Agreement

The Utility has entered into two agreements with the Minnesota Municipal Power Agency (MMPA) to sell a maximum 100 megawatts of power annually from its Silver Lake Plant to MMPA. Under the terms of the agreements, 100 megawatts of power is sold at fixed rates for providing the availability of generating capacity. The Utility is reimbursed for the fuel-related costs of generating power for half of the energy production. The remaining half of the energy produced is sold into the Midwest Independent System Operator (MISO) market at market-based rates adjusted for SO2 allowance consumption under a margin-sharing arrangement. The Utility has an additional agreement with MMPA to market energy from its Cascade Creek combustion turbines (approximately 82 megawatts) into the MISO market, also under a margin-sharing arrangement.

Revenue under these agreements for the years ended December 31, 2009 and 2008 was as follows:

	2009	2008
kWh provided	59,107,789	230,182,743
Payments for availability	$ 3,347,060	$ 3,404,100
Reimbursed generation costs	$ 69,765	$ 5,437,708
Market-based sales	$ 2,473,007	$ 10,276,515

Service Territory Settlements

Under an agreement with People's Cooperative Services (PCS), the Utility is required to make payments to PCS related to the acquisitions of certain electric service rights from PCS. The agreement is valid until December 31, 2012 and is automatically renewed annually thereafter, subject to either party electing to terminate it. For annexations under 80 acres, payments are based upon the amount of electricity sold in specific annexations over a ten-year term starting with the first permanent service in each annexation, with the payment term being negotiated for annexations over 80 acres. The payment varies by each settlement agreement and ranges from 5.7 mills (tenths of a cent) per kWh to 15 mills per kWh with future rates indexed for inflation. These commitments expire over various periods as determined by the length of the term for each annexation. Costs are recognized under these agreements as service is provided.

Report of Independent Auditors

To the Public Utility Board
City of Rochester, Minnesota

We have audited the consolidated statements of net assets of Rochester Public Utilities as of December 31, 2009 and 2008 and the related consolidated statements of revenues, expenses and changes in net assets, and cash flows for the years then ended. These financial statements are the responsibility of Rochester Public Utilities' management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits 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. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed more fully in Note 1, the consolidated financial statements present only the Electric and Water Funds and are not intended to present fairly the financial position of the City of Rochester and the results of its operations and the cash flows of its proprietary fund types in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Rochester Public Utilities as of December 31, 2009 and 2008, and the changes in its net assets and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

The management's discussion and analysis on pages 24 through 33 is not a required part of the basic financial statements, but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Smith, Schafer and Associates, Ltd.

Smith, Schafer and Associates, Ltd.
Certified Public Accountants
March 31, 2010
Rochester, Minnesota

Operating and Financial Statistics (unaudited)

ELECTRIC	2009	2008	2007	2006	2005	2000 (10 years ago)
Retail Customers:						
Residential	43,123	42,861	42,429	41,926	41,179	35,575
General Service	4,546	4,540	4,519	4,501	4,401	3,775
Industrial / Commercial	2	2	2	2	2	2
Other	4	4	4	4	4	4
Total Retail Customers	47,675	47,407	46,954	46,433	45,586	39,356
Retail Sales: (mWh)						
Residential	325,400	328,030	342,601	333,685	327,162	266,869
General Service	633,700	640,711	640,913	623,563	608,760	564,983
Industrial / Commercial	246,180	306,828	307,952	292,580	286,246	245,260
Other	15,808	15,534	16,431	16,888	16,278	15,912
Total Retail Sales (mWh)	1,221,088	1,291,103	1,307,897	1,266,716	1,238,446	1,093,024
Retail Revenue:						
Residential	$39,405,261	$37,790,777	$37,758,843	$33,537,874	$29,724,751	$22,143,004
General Service	60,130,384	57,912,677	55,981,623	49,559,854	43,813,580	36,830,277
Industrial / Commercial	18,984,349	21,159,879	20,276,556	17,183,144	15,484,581	12,932,888
Other	2,439,887	2,305,934	2,303,018	2,088,066	1,857,280	1,580,620
Total Retail Revenue	$120,959,881	$119,169,267	$116,320,040	$102,368,938	$90,880,192	$73,486,789
Steam Sales (MLBs)	438,810	346,449	391,828	165,676	17,934	–
Steam Revenues	$5,178,145	$3,771,825	$4,449,701	$2,617,899	$281,966	–
Annual Peak (Megawatts)	261.0	270.4	276.2	288.3	263.8	228.2
Total mWh Generated	66,726	231,848	395,558	304,571	317,899	314,358
Total mWh Purchased	1,235,082	1,324,665	1,338,176	1,287,672	1,262,310	11,235,719
Year End Cash & Investment Balance	$46,566,146	$40,265,406	$61,308,702	$22,477,464	$22,396,555	$45,857,123

WATER	2009	2008	2007	2006	2005	2000 (10 years ago)
Retail Customers:						
Residential	33,337	33,044	32,671	32,143	31,477	26,454
Industrial / Commercial	3,395	3,369	3,399	3,384	3,284	2,802
Total Retail Customers	36,732	36,413	36,070	35,527	34,761	29,256
Retail Sales: (ccf)						
Residential	3,007,600	3,070,783	3,180,064	3,176,005	3,002,546	2,709,202
Industrial / Commercial	2,877,666	2,995,159	3,189,389	3,081,764	2,912,014	3,101,765
Total Retail Sales (ccf)	5,885,266	6,065,942	6,369,453	6,257,769	5,914,560	5,810,967
Retail Revenue:						
Residential	$4,202,344	$4,221,429	$4,257,801	$4,017,533	$3,677,305	$2,598,930
Industrial / Commercial	2,680,653	2,750,233	2,865,348	2,643,985	2,392,942	1,965,207
Public Fire Protection	541,544	536,193	528,748	494,712	450,215	248,790
Total Retail Revenue	$7,424,541	$7,507,855	$7,651,897	$7,156,230	$6,520,462	$4,812,927
Total Pumped (billion gallons)	4.7	4.8	5.1	5.1	4.7	4.6
Year End Cash & Investment Balance	$5,869,010	$5,332,076	$3,843,521	$3,330,428	$1,523,848	$1,359,954

General Information

Rochester Public Utilities Leadership

Larry Koshire, **General Manager**
Mark Kotschevar, **Director of Core Services**
Susan Parker, **Director of Corporate Services**
Jim Walters, **Director of Customer Relations**
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 and City Council Liaison,** *City Council President, City of Rochester* & *Director of Business Development, Kruse Lumber*

Advisors and Consultants

Smith, Schafer and Associates, Ltd., **Independent Auditors**
Briggs & Morgan, **Bond Counsel**
Springsted Public Finance Advisors, **Financial Advisors**

Headquarters

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Rochester, MN 55906-2813
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507-280-1500
www.rpu.org

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we pledge, we deliver

Rochester Public Utilities Leadership

Pictured from left to right:
Jim Walters, **Director of Customer Relations**
Walter Schlink, **Director of Power Resources**
Larry Koshire, **General Manager**
Joe Hensel, **Director of Field Services**
Susan Parker, **Director of Corporate Services**
Mark Kotschevar, **Director of Core Services**










Rochester Public Utilities Utility Board

Pictured from left to right:
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 and City Council Liaison,** *City Council President, City of Rochester* & *Director of Business Development, Kruse Lumber*

Rochester Public Utilities

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