



RPU CORE VALUE: SERVICE
Leave every individual with a positive impression.

2017 ANNUAL REPORT



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Cover Photo By Marie Ferguson
Mutual Aid Caravan to Florida for Hurricane Irma Response

INDEPENDENT AUDITORS' REPORT

To the Public Utilities Board
Rochester Public Utilities
Rochester, Minnesota

Report on the Financial Statements

We have audited the accompanying financial statements of Rochester Public Utilities, enterprise funds of the City of Rochester, Minnesota, as of and for the year ended December 31, 2017, and the related notes to the financial statements, as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express opinions on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to Rochester Public Utilities' preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of Rochester Public Utilities' internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

Opinions

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, 2017, and the respective changes in financial position and cash flows thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As discussed in Note 1, the financial statements present only Rochester Public Utilities enterprise funds and do not purport to, and do not, present fairly the financial position of the City of Rochester, Minnesota, as of December 31, 2017, and the respective changes in financial position, or cash flows thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America. Our opinions are not modified with respect to this matter.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the required supplementary information as listed in the table of contents be presented to supplement the financial statements. Such information, although not a part of the financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the financial statements, and other knowledge we obtained during our audit of the financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Information

Our audit was conducted for the purpose of forming opinions on the financial statements as a whole. The Operating and Financial Statistics as identified in the table of contents are presented for purposes of additional analysis and are not a required part of the financial statements. Such information has not been subjected to the auditing procedures applied in the audit of the financial statements, and accordingly, we express no opinion or provide any assurance on it.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have issued our report dated March 30, 2018 on our consideration of Rochester Public Utilities' internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering Rochester Public Utilities' internal control over financial reporting and compliance.

Baker Tilly Virchow Krause, LLP

Madison, Wisconsin
March 30, 2018

MANAGEMENT DISCUSSION & ANALYSIS

(Unaudited)

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, 2017 compared to the year ended December 31, 2016.

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

Financial Statements

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

Notes to Financial Statements

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

See accompanying *Independent Auditors' Report*.

HIGHLIGHTS

- Rochester continued to grow with 939 new electric customers and 434 new water customers added in 2017. This compares with growth of 1,520 electric customers and 481 water customers in 2016.
- Electric retail revenues were up 3.4% over 2016, while kilowatt-hour sales were down by 1.8%. The majority of the increase in revenues was due to a 3.7% overall rate increase effective January 1, 2017, offset partially by the decrease in kilowatt-hour sales. Another contributing factor to the increase was the Power Cost Adjustment (PCA), which passes through changes in wholesale power costs over or under a set base amount. Southern Minnesota Municipal Power Agency (SMMPA), RPU's primary wholesale power supplier, had a 6.0% general rate increase in 2016 and an effective rate increase of 2.0% in 2017. The annual system peak demand of 266 megawatts was set in July, and compares with a peak demand of 276 megawatts in 2016 and the all-time system peak demand of 292 megawatts in 2011.
- Water retail revenues were up 7.1% over 2016, while sales volume was up 0.8%. The increase in revenues was due to a 6.0% rate increase effective January 1, 2017 combined with the small increase in sales volume.
- An Electric Utility cost-of-service study was completed in 2014, and a 3-year rate track covering the years 2015 through 2017 was approved by the Utility Board and City Council. The third year's original rate increase of 1.7% was changed to 3.7% to accommodate the acceleration of the Westside Energy Station project, the accompanying bond issue and the related debt service payment. The increase was effective January 1, 2017. A Water Utility cost-of-service study was completed in 2015, with the Utility Board voting for and City Council approving a 3-year rate track covering 2016 through 2018. The second year's rate increase of 6.0% was effective January 1, 2017. The rate increases were needed to build reserves for the future replacement of aging infrastructure, support the operation and maintenance of the utility, and make long-term investments to address the reliability, efficiency and growth of both Utilities.
- Rates for purchased power from SMMPA increased 1.0% in 2017. On-peak hours included in SMMPA's time-of-use rate structure were also expanded which had the effect of an additional 1.0% increase. Purchased power costs from SMMPA and the Midcontinent Independent System Operator (MISO) market represented 69% of electric operating expenses for 2017.
- After a year of planning, the RPU Board approved a \$12.5 million expansion and renovation project of the thirty year old Service Center facility in late 2017. The expansion and renovation will address long term space and service needs adding approximately 27,000 square feet of new garage space and 12,000 square feet of new office space, along with substantial renovation of a portion of the existing facility. RPU staff will continue to occupy the Service Center throughout the renovation which is scheduled to be substantially complete by December 2018.

See accompanying *Independent Auditors' Report*.

- In September 2017, RPU, along with fifteen other Minnesota municipal utilities, sent lineworker crews to Kissimmee, Florida to help with restoration efforts after Hurricane Irma. The crews were there for two weeks helping to restore power to customers in Kissimmee as well as Lake Worth, Florida.
- A cost-of-service study was completed in 2017 for the Electric Utility, and a two-year rate track covering the years 2018 and 2019 was proposed. The Utility Board elected to approve a one-year increase of 1.5% for 2018, which was also approved by the City Council in November 2017.
- Work continued in 2017 on the new customer service and billing system implementation project, with a go-live expected to take place mid-2018. The new software system will improve customer self-service options and provide real-time applications and field mobility capabilities, along with realizing substantial cost savings over the current vendor. In tandem with the software, a new communications platform will enhance customer preference options and proactive communications with customers.
- The Douglas Trail Substation, a high voltage substation located on West Circle Drive, was placed into service the week of June 5, 2017. The substation was built to serve customer load growth in northwest Rochester.
- The Westside Energy Station, located on a 50-acre site on the west side of Rochester, reached Significant Completion in December 2017, six weeks ahead of schedule. Performance and emission compliance testing was performed in December. Formal operator training will be conducted in 2018, along with site restoration and construction of a warehouse building. The prime movers at the Energy Station are reciprocating internal combustion engines driving generators with a combined output of 46 megawatts. The project scope included an engine hall, control room, switchgear room, maintenance facilities, administrative offices and conference rooms which will serve a dual purpose as an emergency location for customer service facilities. Commercial operation began March 20, 2018.
- In February 2017, RPU had its largest bond issue in history with a total issuance of \$108.3 million. Of the total issuance, \$20.9 million refunded the U.S. Bank credit facility, \$21.6 million refunded the outstanding balance of the existing 2007C bond issue, and the remaining \$65.8 million, along with a \$17.3 million premium received, financed the remaining construction of the Westside Energy Station and the expansion and renovation of the Service Center facility.
- RPU surpassed its Aggressive Demand-Side Management (DSM) goal for 2017 of 18,647 megawatt hours in energy savings. Actual energy savings of 28,233 megawatt hours were achieved through helping commercial and residential customers install energy efficient equipment and technologies. This represents an estimated 28,233 tons of carbon reduction. The energy savings also represent 2.4% of annual retail energy sales. Savings of 4.2 million gallons of water were achieved through the use of water conservation rates, customer education, leak detection and rebates offered on clothes washers, high efficiency toilets, rain barrels and other items. This was an increase of 1.4 million gallons over 2016.

See accompanying *Independent Auditors' Report*.

FINANCIAL ANALYSIS – ELECTRIC UTILITY

Condensed Financial Information – Electric Utility

December 31, 2017 and 2016

(In millions)

Statements of Revenues, Expenses, & Changes in Net Position

	2017	2016	Change 2017 vs. 2016
Operating Revenues	\$160.7	\$156.4	\$4.3
Operating Expenses	134.4	132.2	2.2
<i>Operating Income</i>	26.3	24.2	2.1
Other Income & Expense	0.2	(0.3)	0.5
Interest Charges	(4.9)	(3.3)	(1.6)
Nonoperating Income (Expense)	(4.7)	(3.6)	(1.1)
<i>Income Before Transfer and Capital Contributions</i>	21.6	20.6	1.0
Transfers Out	(8.7)	(8.5)	(0.2)
Capital Contributions	3.0	3.1	(0.1)
<i>Change in Net Position</i>	15.9	15.2	0.7
Net Position - Beginning of Year	134.7	119.5	15.2
Net Position - End of Year	\$150.6	\$134.7	\$15.9

Statements of Net Position

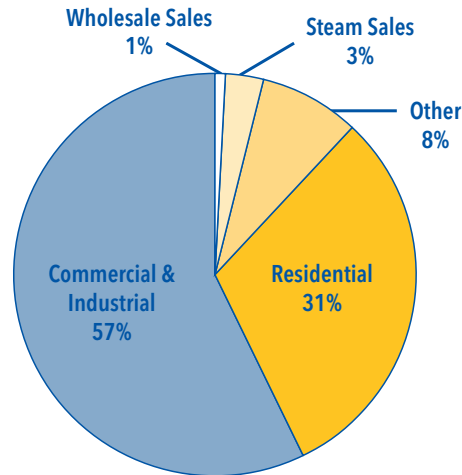
	2017	2016	Change 2017 vs. 2016
Cash and Investments – Unrestricted	\$56.8	\$40.8	\$16.0
Cash and Investments – Restricted	1.2	0.7	0.5
Other Current Assets	25.6	23.1	2.5
Capital Assets, Net	261.5	211.2	50.3
Other Noncurrent Assets	48.6	17.2	31.4
<i>Total Assets</i>	393.7	293.0	100.7
Deferred Outflows of Resources	8.0	9.3	(1.3)
Total Assets Plus Deferred Outflows of Resources	\$401.7	\$302.3	\$99.4
Current Liabilities	\$24.9	\$25.8	\$(0.9)
Long-Term Debt	200.0	119.1	80.9
Other Noncurrent Liabilities	20.4	19.1	1.3
<i>Total Liabilities</i>	245.3	164.0	81.3
Deferred Inflows of Resources	5.8	3.6	2.2
Investment in Capital Assets	93.3	94.9	(1.6)
Restricted – Debt Service	0.4	0.3	0.1
Unrestricted	56.9	39.5	17.4
<i>Net Position</i>	150.6	134.7	15.9
Total Liabilities, Deferred Inflows of Resources and Net Position	\$401.7	\$302.3	\$99.4

See accompanying *Independent Auditors' Report*.

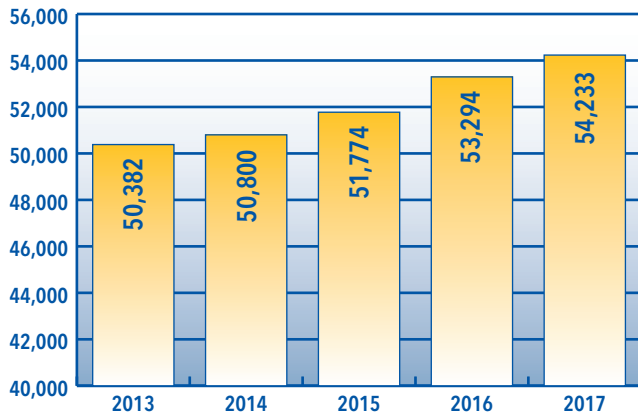
OPERATING REVENUES

Operating revenues increased \$4.3 million (2.7%) in 2017. Retail revenues were up \$4.8 million (3.4%) due to a 3.7% rate increase effective January 1, 2017, as well as an increase in the amount billed through the Power Cost Adjustment. This was partially offset by a decrease in kilowatt-hour sales. Wholesale revenues decreased \$0.5 million (21.1%), while other operating revenues remained steady.

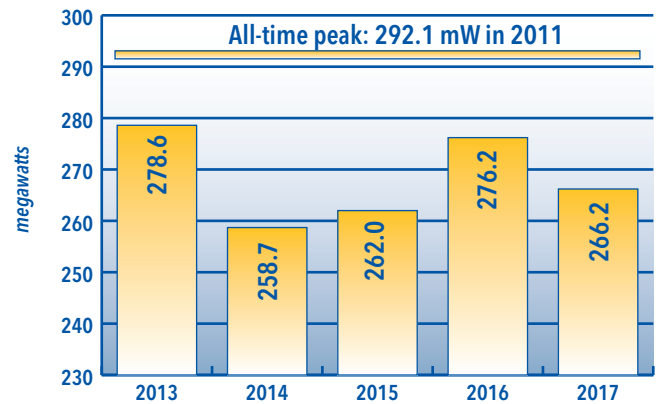
Electric Operating Revenues



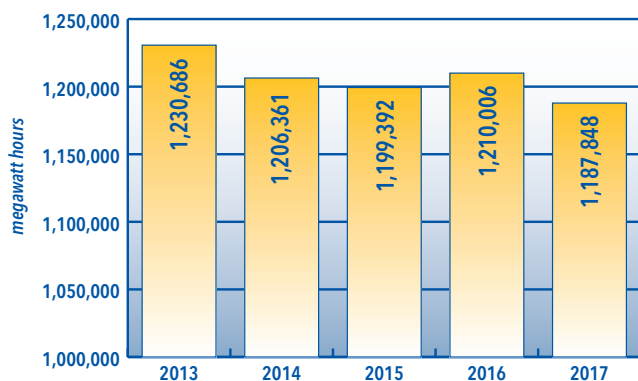
Number of Electric Customers



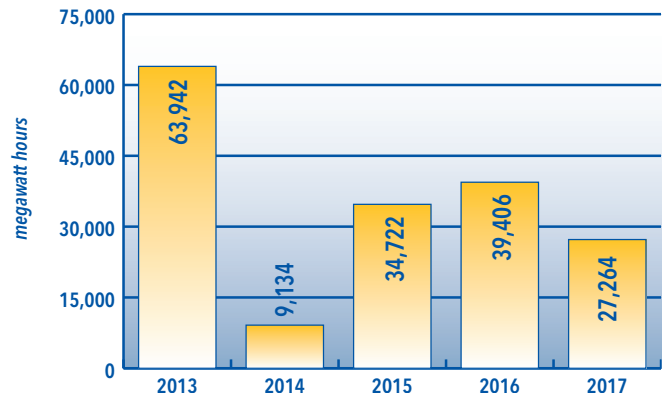
Electric System Peaks



Electric Retail Sales



Electric Wholesale Sales

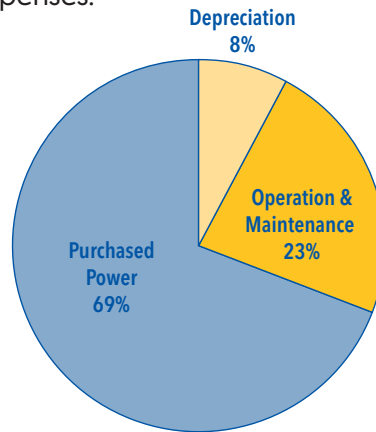


See accompanying *Independent Auditors' Report*.

OPERATING EXPENSES

Operating expenses increased \$2.2 million (1.7%) in 2017, due primarily to an increase in depreciation from the addition of the CapX transmission line late in 2016 and the Douglas Trail Substation in 2017. Purchased power, salaries and benefits, and materials, supplies and services also accounted for part of the increase, offset by a small decrease in generation fuel. The primary driver of operating expenses for the Electric Utility continues to be purchases of power from SMPA and the MISO market, which comprised 69% of total operating expenses.

Electric Operating Expenses



TRANSFERS OUT

The Electric Utility makes transfers to the City of Rochester’s General Fund each month based on retail kilowatt-hours sold (in lieu of tax). Transfers to the City totaled \$8.4 million and \$8.5 million in 2017 and 2016 respectively. The in lieu of tax amount was relatively flat due to a decrease in kilowatt-hour sales partially offset by an increase in the in lieu of tax rate.

An additional transfer out of \$0.3 million is attributable to the Electric Utility paying the Water Utility for the cost of extending water main infrastructure to the Westside Energy Station.

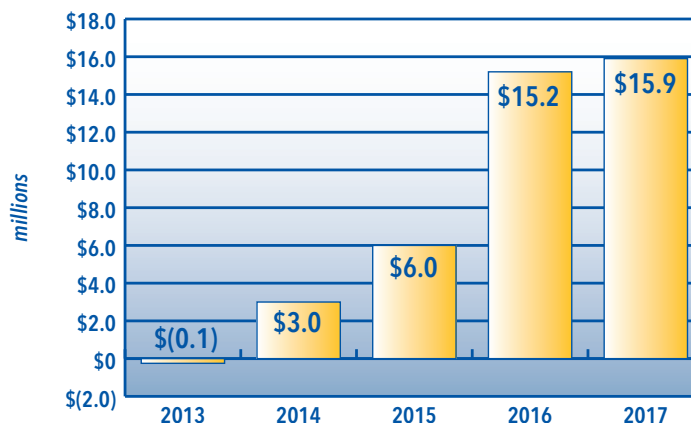
CAPITAL CONTRIBUTIONS

Capital contributions decreased by \$0.1 million in 2017, showing consistency with the prior year.

CHANGE IN NET POSITION

The increase in net position for 2017 was \$15.9 million, an improvement of \$0.7 million over 2016. Several factors contributed to this improvement. Retail revenues increased \$4.8 million over 2016 offset by a \$0.4 million increase in purchased power for a net improvement of \$4.4 million. This was partially offset by other operating expenses increasing \$2.0 million over 2016, and bond interest expense increasing \$1.7 million over 2016.

Electric – Change in Net Position

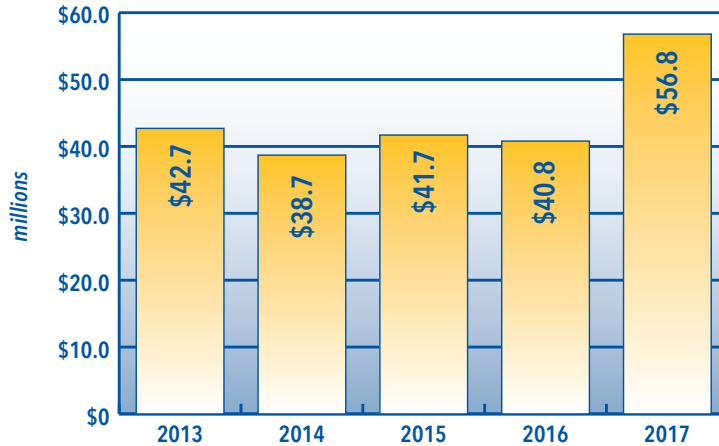


See accompanying *Independent Auditors’ Report*.

CASH, INVESTMENTS AND OTHER ASSETS

The ending current unrestricted cash and investments balance for 2017 was \$56.8 million, \$16.0 million higher than 2016. Approximately \$8.1 million of the increase came from the reimbursement of prior capital expenditures out of proceeds from the 2017A bond issue. The ending current restricted cash and investments balance for 2017 was \$1.2 million, \$0.5 million higher than 2016. This amount represents funds restricted for debt service payments. Other current assets for 2017 were \$25.6 million, \$2.5 million higher than 2016. This increase was due primarily to increases in the Power Cost Adjustment accrual and accrued utility revenues. Other noncurrent assets for 2017 were \$48.6 million, \$31.4 million higher than 2016. This was due to unspent bond proceeds remaining at the end of the year as well as an increase in the debt service reserve fund balance as a result of the 2017A bond issue.

Electric – Unrestricted Cash & Investments



LIABILITIES

Current liabilities decreased \$0.9 million in 2017.

Noncurrent liabilities increased \$1.3 million in 2017 due to an increase in unearned revenues, offset by a decrease in pension liability for the Utility's proportionate share of the liability from the Minnesota Public Employees Retirement Association (PERA).

NET POSITION

Net position invested in capital assets reflects additions to capital assets funded through rate-based revenues and fees from customers, net of debt proceeds expended on capital projects. In 2017, net position invested in capital assets decreased \$1.6 million compared to 2016.

Restricted net position increased \$0.1 million. This represents funds restricted for payment of debt service.

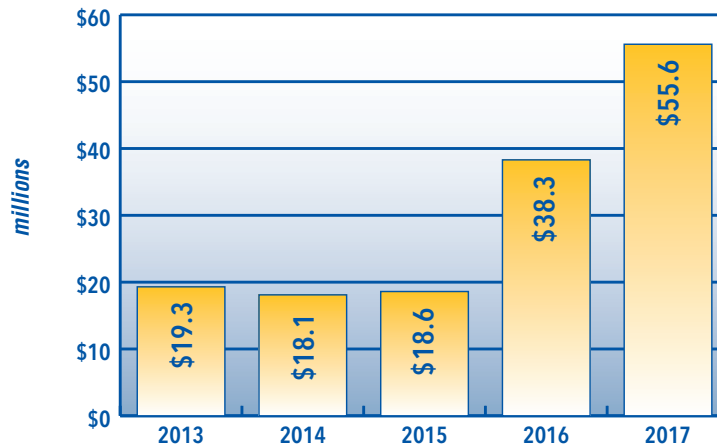
Unrestricted net position is not subject to any constraints by debt covenants or other legal requirements. In 2017, unrestricted net position increased \$17.4 million due to the results of operations.

See accompanying *Independent Auditors' Report*.

CAPITAL ASSETS

At December 31, 2017, the Electric Utility had \$261.5 million invested in a broad range of utility capital assets, including a 46 megawatt reciprocating engine generation plant, two gas turbines, a hydro-electric power generation plant, two diesel generators, boiler plant and related equipment to provide steam to a large customer, electric transmission and distribution facilities, and various buildings and equipment. Capital assets increased \$56.6 million in 2017, reflecting investments in generation plant, general facilities and the distribution and transmission systems. The increase in capital assets was offset by a \$6.3 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 expenditures increased by \$17.3 million in 2017, due in large part to work on the Westside Energy Station.

Electric – Capital Expenditures



LONG-TERM DEBT

At the end of 2017, the Utility had \$182.4 million in revenue bonds outstanding. New debt in the amount of \$108.3 million was issued in February 2017. Of this total, \$20.9 million was used to refund the U.S. Bank credit facility, and \$21.6 million to refund the outstanding balance of the 2007C bond issue due to lower interest rates. The remaining \$65.8 million along with a \$17.3 million premium received was used as permanent financing for the Westside Energy Station as well as the expansion and renovation of the Service Center facility. In addition to the new debt issued, \$48.2 million was retired in 2017.

The Utility maintained an AA- bond rating from Fitch, and an Aa3 rating from Moody's. Additional details regarding the Utility's long-term debt may be found in Note 6 to the financial statements.

See accompanying *Independent Auditors' Report*.

FINANCIAL ANALYSIS – WATER UTILITY

Condensed Financial Information – Water Utility

December 31, 2017 and 2016

(In millions)

Statements of Revenues, Expenses, & Changes in Net Position

	2017	2016	Change 2017 vs. 2016
Operating Revenues	\$10.2	\$9.5	\$0.7
Operating Expenses	9.5	9.1	0.4
<i>Operating Income</i>	0.7	0.4	0.3
<i>Income Before Transfers and Capital Contributions</i>	0.7	0.4	0.3
Transfers Out (In Lieu Of Tax Payments)	(0.4)	(0.4)	-
Capital Contributions	2.8	2.8	-
<i>Change in Net Position</i>	3.1	2.8	0.3
Net Position - Beginning of Year	99.6	96.8	2.8
Net Position - End of Year	\$102.7	\$99.6	\$3.1

Statements of Net Position

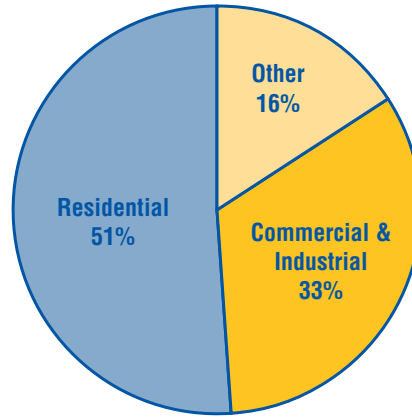
	2017	2016	Change 2017 vs. 2016
Cash and Investments	\$7.1	\$5.7	\$1.4
Other Current Assets	0.9	0.8	0.1
Capital Assets, Net	97.5	95.8	1.7
<i>Total Assets</i>	105.5	102.3	3.2
Deferred Outflows of Resources	0.8	0.9	(0.1)
Total Assets Plus Deferred Outflows of Resources	\$106.3	\$103.2	\$3.1
Current Liabilities	\$0.8	\$0.8	\$ -
Noncurrent Liabilities	1.9	2.3	(0.4)
<i>Total Liabilities</i>	2.7	3.1	(0.4)
Deferred Inflows of Resources	0.9	0.5	0.4
Investment in Capital Assets	97.5	95.8	1.7
Unrestricted	5.2	3.8	1.4
<i>Net Position</i>	102.7	99.6	3.1
Total Liabilities, Deferred Inflows of Resources and Net Position	\$106.3	\$103.2	\$3.1

See accompanying *Independent Auditors' Report*.

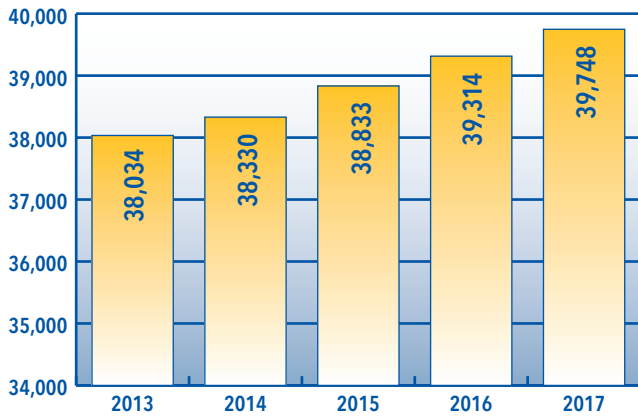
OPERATING REVENUES

Operating revenues increased by \$0.7 million (7.4%) in 2017. Retail revenues were up \$0.6 million (7.1%), due primarily to a 6.0% rate increase effective January 1, 2017, as well as a small increase in sales volume.

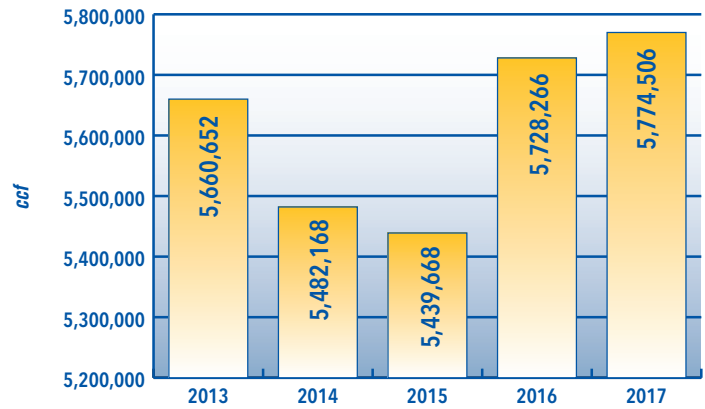
Water Operating Revenues



Number of Water Customers



Water Retail Sales

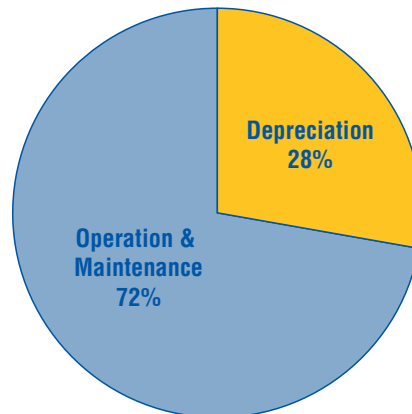


See accompanying *Independent Auditors' Report*.

OPERATING EXPENSES

Operating expenses increased by \$0.4 million (4.4%) in 2017 due to increases in depreciation, salaries and benefits, and materials, supplies and services.

Water Operating Expenses



IN LIEU OF TAX PAYMENTS

The Water Utility makes transfers to the City of Rochester's General Fund each month based on the retail water volume (ccf - hundred cubic feet) sold. In 2017, \$370,000 was transferred to the City. This was an increase of \$7,000 over 2016 due to an increase in the ccf sales volume and an increase in the in lieu of tax rate.

CAPITAL CONTRIBUTIONS

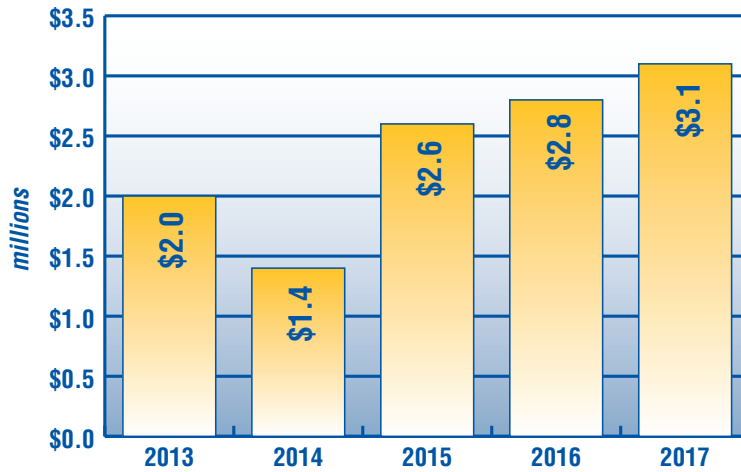
Capital contributions remained approximately the same in 2017. These are assets, primarily water mains and fire hydrants, which are contributed to the Water Utility from both the City and developers and are valued using a costing database that estimates their approximate construction costs. Beginning in 2013, the Utility took over the responsibility of paying for new water towers and reservoirs out of its own funds. The City collects a Water Availability Charge (WAC) specifically for this purpose and these funds will be used to reimburse the Water Utility for all or part of the cost of constructing new towers and reservoirs. No WAC funds were received in 2017.

See accompanying *Independent Auditors' Report*.

CHANGE IN NET POSITION

The increase in net position for 2017 was \$3.1 million, \$0.3 million higher than in 2016. This is due to a net increase in operating income in 2017.

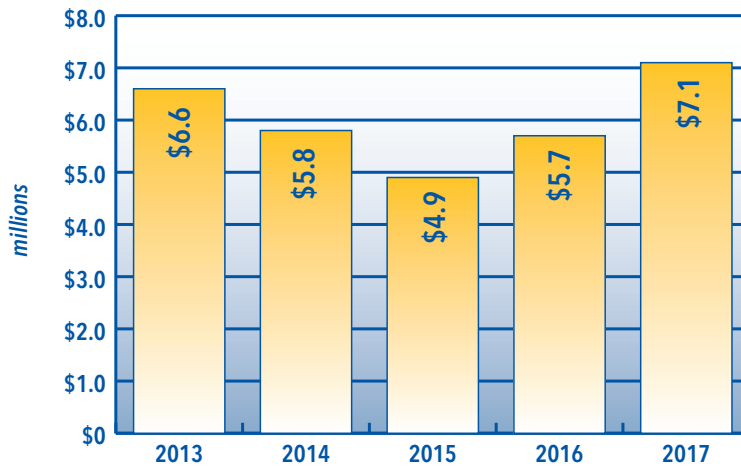
Water – Change in Net Position



CASH, INVESTMENTS AND OTHER ASSETS

The ending unrestricted cash and investments balance for 2017 was \$7.1 million, \$1.4 million higher than 2016.

Water – Unrestricted Cash & Investments



See accompanying *Independent Auditors' Report*.

LIABILITIES

Current liabilities remained approximately the same in 2017.

Noncurrent liabilities decreased \$0.4 million in 2017 due to a decrease in pension liability for the Utility's proportionate share of the liability from the Minnesota Public Employees Retirement Association (PERA).

NET POSITION

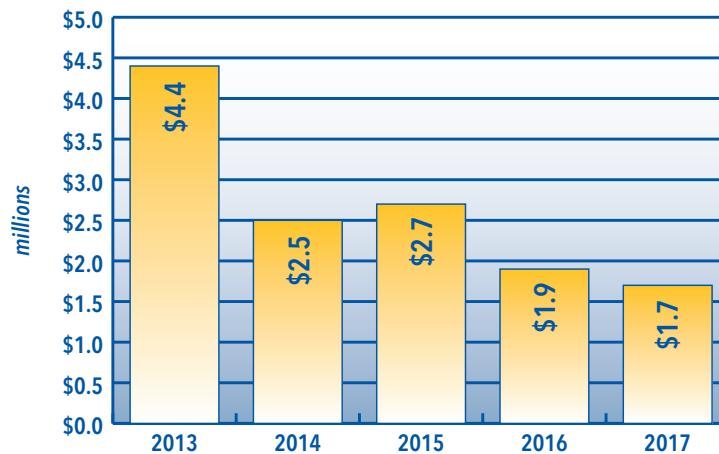
Net position invested in capital assets increased \$1.7 million. This increase reflects additions to capital assets funded through rate-based revenues and fees from customers as well as contributed assets.

Unrestricted net position is not subject to any constraints established by debt covenants or other legal requirements. In 2017, unrestricted net position increased \$1.4 million due to the results of operations.

CAPITAL ASSETS

At December 31, 2017, the Water Utility had \$97.5 million invested in a broad range of utility capital assets, including 20 water storage facilities, 32 wells, water mains, pump station facilities, buildings, and equipment. Capital assets increased \$4.2 million in 2017, 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 \$2.5 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 expenditures decreased by \$0.2 million in 2017. Some of the major expenditure components in 2017 were RPU projects, City projects, and metering.

Water – Capital Expenditures



See accompanying *Independent Auditors' Report*.

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 November 2016, the Utility Board approved a 3.7% rate increase for 2017 for the Electric Utility and a 6.0% rate increase for the Water Utility. The rate increases will build reserves for future replacement of infrastructure and maintain the financial health of both Utilities. The table below compares historical Electric and Water rate increases with the annual inflation rate, as well as an average for the last five years.

ROCHESTER PUBLIC UTILITIES ELECTRIC AND WATER RATE CHANGE VERSUS INFLATION

<u>Year</u>	<u>Inflation %</u>	<u>Electric Rates %</u>	<u>Water Rates %</u>
2018	2.0%*	1.5%	6.0%
2017	2.1%*	3.7%	6.0%
2016	1.3%	1.7%	6.0%
2015	0.1%	3.5%	3.5%
2014	1.6%	3.0%	1.5%
Annualized Average	1.4%	2.7%	4.6%

*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, replacement of aging infrastructure, accelerated debt payments, future supply costs, regulatory changes, and others. Growth of the city directly affects several of these factors.

The housing market has been increasing. In 2017, there were 437 building permits totaling \$119.3 million issued for single-family homes as compared to 421 permits totaling \$101.5 million in 2016. Commercial building permits had a much larger increase, with 71 permits totaling \$114.5 million in 2017 as compared to 35 permits totaling \$34.6 million in 2016.

According to the US Department of Labor Bureau of Labor Statistics, the December 2017 unemployment rate of 2.8% for the area remains well below the state and national rates of 3.4% and 4.1%, respectively. The employment data shows that, on average, there were slightly more people working in the Rochester area than the previous year.

See accompanying *Independent Auditors' Report*.

The Destination Medical Center (DMC) initiative continues to develop and is projected to have a major impact on the future economic growth of the city. Legislation passed in 2013 required two bodies to be created: the DMC Corporation, an oversight body, and the DMC Economic Development Agency (EDA), a private nonprofit agency that contracts with the DMC Corporation Board to act as its staff, working with the City of Rochester and other stakeholders to develop and execute the DMC plans and strategy. These two groups were organized in 2013 and 2014 and now meet regularly. In March 2014, the EDA began work on the DMC Development Plan, which was adopted by the City of Rochester in March 2015 and by the DMC Corporation in April 2015. The EDA, working with stakeholder organizations and the City of Rochester, is now charged with implementing the DMC Development Plan over the next 20 years. Specifically for Rochester, this will mean the creation of thousands of new jobs and an estimated \$270 million in additional tax revenue over the next 20 years, along with the creation and retention of new businesses with a focus on biotech companies. Current priorities include Discovery Square, an integrated district for the future of biomedical, research, education, and technology innovation; Heart of the City, which would extend and enhance Peace Plaza; and transportation.

Based on the assumption that future growth will mirror our recent historical growth, and the cost of service studies completed in 2015 for the Water Utility and 2017 for the Electric Utility, the RPU Board and Rochester City Council have approved a 1.5% general rate increase in 2018 for the Electric Utility and a 6% general rate increase for the Water Utility.

Rochester Public Utilities continues to provide a customer focused reliable service to a vibrant and growing Rochester area through efficient, reliable and responsible operations that work to serve our customers and community.

REQUESTS FOR INFORMATION

The 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.

See accompanying *Independent Auditors' Report*.

Electric Utility

Statement of Net Position

As of December 31, 2017

	2017
ASSETS:	
Current Assets:	
Cash and Cash Equivalents	\$7,913,016
Investments	48,929,771
Accounts Receivable (Net) and Accrued Utility Revenues	19,747,285
Inventories	4,868,762
Other Current Assets	1,019,434
Restricted Assets:	
Cash and Cash Equivalents	1,174,333
Total Current Assets	83,652,601
Noncurrent Assets:	
Restricted Assets:	
Cash and Cash Equivalents	23,073,722
Investments	12,955,835
Capital Assets:	
Construction Work in Progress	76,274,809
Land and Land Rights	9,619,257
Depreciable Assets, Net	175,563,811
Net Capital Assets	261,457,877
Other Assets	12,576,723
Total Noncurrent Assets	310,064,157
Total Assets	393,716,758
DEFERRED OUTFLOWS OF RESOURCES	
Deferred Bond Refunding	1,326,102
Pension Deferred Outflows of Resources	6,698,740
Total Deferred Outflows of Resources	8,024,842
Total Assets Plus Deferred Outflows of Resources	\$401,741,600
LIABILITIES:	
Current Liabilities:	
Accounts Payable	\$12,968,951
Due to the Municipality	2,779,427
Accrued Compensated Absences	1,659,179
Accrued Compensation	402,924
Customer Deposits	858,354
Current Liabilities Payable from Restricted Assets	
Interest Payable	719,333
Current Maturities of Long-Term Debt	5,460,000
Total Current Liabilities	24,848,168
Noncurrent Liabilities:	
Accrued Compensated Absences	1,249,821
Pre-1968 Pensions Liability	6,000
Net Pension Liability	15,060,666
Unearned Revenues	4,102,700
Long-Term Debt	200,038,796
Total Noncurrent Liabilities	220,457,983
Total Liabilities	245,306,151
DEFERRED INFLOWS OF RESOURCES	
Deferred Revenue	446,855
Pension Deferred Inflows of Resources	5,346,164
Total Deferred Inflows of Resources	5,793,019
NET POSITION:	
Net Investment in Capital Assets	93,314,740
Restricted	
Debt Service	455,000
Unrestricted	56,872,690
Total Net Position	150,642,430
Total Liabilities, Deferred Inflows of Resources and Net Position	\$401,741,600

See accompanying *Notes to Financial Statements*.

Electric Utility

Statement of Revenues, Expenses, and Changes in Net Position

For the Year Ended December 31, 2017

	2017
Operating Revenues:	
Retail	\$146,778,830
Wholesale	1,822,298
Other	12,178,970
Total Operating Revenues	<u>160,780,098</u>
Operating Expenses:	
Purchased Power	93,061,685
Operations and Maintenance	30,394,251
Depreciation	10,554,847
Amortization of Regulatory Assets	419,967
Total Operating Expenses	<u>134,430,750</u>
Operating Income	<u>26,349,348</u>
Nonoperating Income (Expenses):	
Investment Income	851,248
Interest Expense	(4,946,276)
Amortization of Regulatory Assets	(92,646)
Miscellaneous, Net	(570,278)
Total Nonoperating (Expenses)	<u>(4,757,952)</u>
Income Before Transfers and Capital Contributions	<u>21,591,396</u>
Transfers Out	(8,421,844)
Capital Transfer to Water	(302,571)
Capital Contributions	3,066,425
Change in Net Position	<u>15,933,406</u>
Net Position, Beginning of Year	<u>134,709,024</u>
Net Position, End of Year	<u><u>\$150,642,430</u></u>

See accompanying *Notes to Financial Statements*.

Electric Utility Statement of Cash Flows

For the Year Ended December 31, 2017

	2017
Cash Flows From Operating Activities:	
Cash Received from Customers	\$162,451,337
Cash Paid to Suppliers	(118,529,336)
Cash Paid to Employees	(15,212,070)
Internal Activity - Payments From Other Funds	6,566,848
Service Territory Acquisition	(314,706)
Net Cash Provided By Operating Activities	<u>34,962,073</u>
Cash Flows From Noncapital Financing Activities:	
Operating Transfers to Other Funds	<u>(8,724,530)</u>
Cash Flows From Capital and Related Financing Activities:	
Additions to Utility Plant and Other Assets	(58,884,052)
Capital Contributions Received	3,066,425
Principal Payments on Bonds	(48,180,000)
Interest Payments on Bonds	(7,943,310)
Bond Issue Costs	(647,188)
Proceeds from Issuance of Bonds	133,092,816
Net Cash Provided By Capital and Related Financing Activities	<u>20,504,691</u>
Cash Flows From Investing Activities:	
Interest Received	851,248
Investment Purchases	(27,103,029)
Investment Redemptions	4,330,669
Net Cash Used In Investing Activities	<u>(21,921,112)</u>
Net Increase in Cash and Cash Equivalents	24,821,122
Cash and Cash Equivalents, Beginning of Year	<u>7,339,949</u>
Cash and Cash Equivalents, End of Year	<u>32,161,071</u>
Classified As:	
Current Nonrestricted Assets	7,913,016
Restricted Assets	24,248,055
Cash and Cash Equivalents, End of Year	<u>\$32,161,071</u>
	2017
Reconciliation of Operating Income to Net Cash Provided by Operating Activities:	
Operating Income	\$26,349,348
Adjustments to Reconcile Operating Income to Net Cash Provided by Operating Activities:	
Depreciation and Amortization	10,974,814
Bad Debts	163,166
Service Territory Payments	(314,706)
Miscellaneous Expense	(570,278)
Interest Expense, Customer Deposits	(3,973)
(Increase) Decrease In:	
Accounts Receivable and Accrued Utility Revenues	(2,272,499)
Inventories	57,785
Other Current Assets	(447,637)
Increase (Decrease) In:	
Accrued Liabilities and Accounts Payable	(7,300,349)
Customer Deposits	266,191
Deferred Lease Revenues	(36,420)
Unearned Revenues	4,102,700
Pension Deferred Outflow/Inflow	3,993,931
Net Cash Provided by Operating Activities	<u>\$34,962,073</u>
Noncash Financing and Investing Activities:	
Allowance for Funds Used During Construction	\$1,414,316
Amortization of Bond Premiums, Discounts, and Refunding	(\$1,875,613)
Amortization of Bond Issue Costs	\$92,646
Unrealized Loss on Investments	(\$335,500)

See accompanying *Notes to Financial Statements*.

Water Utility

Statement of Net Position

As of December 31, 2017

	2017
ASSETS:	
Current Assets:	
Cash and Cash Equivalents	\$991,554
Investments	6,131,229
Accounts Receivable (Net) and Accrued Utility Revenues	664,638
Materials and Supplies Inventory	183,655
Other Current Assets	62,361
Total Current Assets	<u>8,033,437</u>
Noncurrent Assets:	
Capital Assets:	
Construction Work in Progress	1,650,867
Land and Land Rights	677,486
Depreciable Assets, Net	95,148,188
Net Capital Assets	<u>97,476,541</u>
Total Noncurrent Assets	<u>97,476,541</u>
Total Assets	<u>105,509,978</u>
DEFERRED OUTFLOWS OF RESOURCES	
Pension Deferred Outflows of Resources	785,265
Total Assets Plus Deferred Outflows of Resources	<u>\$106,295,243</u>
LIABILITIES:	
Current Liabilities:	
Accounts Payable	\$339,335
Due to the Municipality	53,243
Accrued Compensated Absences	255,406
Accrued Compensation	48,835
Customer Deposits	80,799
Total Current Liabilities	<u>777,618</u>
Noncurrent Liabilities:	
Accrued Compensated Absences	192,904
Net Pension Liability	1,756,779
Total Noncurrent Liabilities	<u>1,949,683</u>
Total Liabilities	<u>2,727,301</u>
DEFERRED INFLOWS OF RESOURCES	
Deferred Revenue	220,964
Pension Deferred Inflows of Resources	625,698
Total Deferred Inflows of Resources	<u>846,662</u>
NET POSITION:	
Net Investment in Capital Assets	97,476,541
Unrestricted	5,244,739
Total Net Position	<u>102,721,280</u>
Total Liabilities, Deferred Inflows of Resources and Net Position	<u>\$106,295,243</u>

See accompanying *Notes to Financial Statements*.

Water Utility

Statement of Revenues, Expenses, and Changes in Net Position

For the Year Ended December 31, 2017

	2017
Operating Revenues:	
Retail	\$9,121,342
Other	1,091,226
Total Operating Revenues	<u>10,212,568</u>
Operating Expenses:	
Operations and Maintenance	6,864,692
Depreciation	2,639,588
Total Operating Expenses	<u>9,504,280</u>
Operating Income	<u>708,288</u>
Nonoperating Income (Expenses):	
Investment Income	89,331
Interest Expense	(51)
Miscellaneous, Net	(132,044)
Total Nonoperating (Expenses)	<u>(42,764)</u>
Income Before Transfers and Capital Contributions	665,524
Transfers Out	(370,319)
Capital Transfer In from Electric	302,571
Capital Contributions	2,492,600
Change in Net Position	<u>3,090,376</u>
Net Position, Beginning of Year	99,630,904
Net Position, End of Year	<u>\$102,721,280</u>

See accompanying *Notes to Financial Statements*.

Water Utility

Statement of Cash Flows

For the Year Ended December 31, 2017

	2017
Cash Flows From Operating Activities:	
Cash Received from Customers	\$10,296,725
Cash Paid to Suppliers	(5,478,648)
Cash Paid to Employees	(1,829,109)
Internal Activity - Payments From Other Funds	195,845
Net Cash Provided By Operating Activities	<u>3,184,813</u>
Cash Flows From Noncapital Financing Activities:	
Operating Transfers to Other Funds	(371,400)
Cash Flows From Capital and Related Financing Activities:	
Additions to Utility Plant and Other Assets	(1,787,930)
Capital Contributions Received	302,571
Net Cash Used In Capital and Related Financing Activities	<u>(1,485,359)</u>
Cash Flows From Investing Activities:	
Interest Received	89,281
Investment Purchases	(2,517,544)
Investment Redemptions	1,161,949
Net Cash Used In Investing Activities	<u>(1,266,314)</u>
Net Increase in Cash and Cash Equivalents	61,740
Cash and Cash Equivalents, Beginning of Year	<u>929,814</u>
Cash and Cash Equivalents, End of Year	<u><u>\$991,554</u></u>

	2017
Reconciliation of Operating Income to Net Cash Provided by Operating Activities:	
Operating Income	\$708,288
Adjustments to Reconcile Operating Income to	
Net Cash Provided by Operating Activities:	
Depreciation	2,639,588
Bad Debts	12,928
Miscellaneous Expense	(132,044)
(Increase) Decrease In:	
Accounts Receivable and Accrued Utility Revenues	(62,454)
Materials and Supplies Inventory	(27,360)
Prepaid and Other Current Assets	(61,618)
Increase (Decrease) In:	
Accrued Liabilities and Accounts Payable	(389,776)
Customer Deposits	22,761
Deferred Revenue	7,730
Pension Deferred Outflow/Inflow	466,770
Net Cash Provided by Operating Activities	<u><u>\$3,184,813</u></u>
Noncash Financing and Investing Activities:	
Additions to Utility Plant and Other Assets Contributed By:	
City's Governmental Funds	\$151,436
Developers	\$2,341,164

See accompanying *Notes to Financial Statements*.

NOTES TO FINANCIAL STATEMENTS

As of and for the Year Ended December 31, 2017

NOTE 1: Summary of Significant Accounting Policies

The financial statements of Rochester Public Utilities (Utilities or RPU) have been prepared in conformity with accounting principles generally accepted in the United States of America as applied to enterprise funds of governmental units. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles.

The significant accounting principles and policies utilized by the Utilities are described below.

REPORTING ENTITY

The Utilities are comprised of two proprietary funds, the Electric and the Water Enterprise Funds of the City of Rochester, Minnesota (municipality). 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 Utilities provide electric and water service to properties concentrated geographically in or near the City of Rochester.

The Utilities are a municipal utility governed by a five-member board under the authority of the Rochester City Council. The equity of the Utilities is vested in the City of Rochester, Minnesota.

MEASUREMENT FOCUS, BASIS OF ACCOUNTING AND FINANCIAL STATEMENT PRESENTATION

The Utilities are presented as enterprise funds of the municipality. Enterprise funds are used to report the same functions presented as business-type activities in the government-wide financial statements.

Activities are accounted for using the flow of economic resources measurement focus and the accrual basis of accounting. Under the accrual basis of accounting, revenues are recognized when earned and expenses are recorded when incurred, even though actual payment or receipt may not occur until after the period ends.

The preparation of financial statements in accordance with generally accepted accounting principles in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets, deferred outflows of resources, liabilities and deferred inflows of resources 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.

ASSETS, DEFERRED OUTFLOWS OF RESOURCES, LIABILITIES, DEFERRED INFLOWS OF RESOURCES AND NET POSITION

Deposits and Investments

For purposes of reporting cash flows the Utilities consider all highly liquid debt instruments purchased with an original maturity of 90 days or less to be cash equivalents.

Investments are stated at fair value, which is the amount at which an investment could be exchanged in a current transaction between willing parties. The bases of fair values are described in the notes to the City of Rochester's basic financial statements included in the City's 2017 Comprehensive Annual Financial Report. No investments are reported at amortized cost. Adjustments necessary to record investments at fair value are recorded in the operating statement as increases or decreases in investment income. Fair values may have changed significantly after year end.

Investments of utilities' funds are restricted by state statutes. Investments are limited to:

- (a) Direct obligations or obligations guaranteed by the United States or its agencies.
- (b) Shares of investment companies registered under the Federal Investment Company Act of 1940 and whose only investments are in securities described in (a) above.
- (c) General obligations of the State of Minnesota or its municipalities.
- (d) Bankers acceptances of United States banks eligible for purchase by the Federal Reserve System.
- (e) Commercial paper issued by United States corporations or their Canadian subsidiaries, of the highest quality, and maturing in 270 days or less.
- (f) Repurchase agreements with banks that are members of the Federal Reserve System with capitalization exceeding \$10,000,000, a reporting dealer to the Federal Reserve Bank of New York, or certain Minnesota securities broker-dealers.
- (g) Money market funds with institutions that have portfolios consisting exclusively of United States Treasury obligations and Federal Agency issues.
- (h) Guaranteed investment contract (gic's) issued or guaranteed by United States commercial banks or domestic branches of foreign banks or United States insurance company and with a credit quality in one of the top two highest categories. Agreements or contracts for guaranteed investment contracts with a term of 18 months or less may be entered into provided that the issuer's or guarantor's long-term unsecured debt is rated in one of the three highest rating categories (minimum A- or the equivalent) and the credit quality of the issuer's short-term unsecured debt is rated in the highest category (minimum A-1 or the equivalent).

As a department of the City of Rochester, MN, the utilities are governed by the investment policy that has been adopted by the Rochester City Council. That policy follows the state statute for allowable investments.

Receivables/Payables and Accrued Utility Revenues

Outstanding balances between the Utilities and the primary government are reported as due from/to the municipality.

The Utilities provides an allowance for losses on receivables, as needed, for accounts considered uncollectible. Accounts receivable has been reduced by an Allowance for Doubtful Accounts of \$220,000 for the Electric Utility and \$20,000 for the Water Utility for December 31, 2017.

Revenues are recognized on the accrual basis of accounting and include estimated amounts for service rendered but not billed. Accrued revenue amounts are \$6,216,518 for the Electric Utility and \$187,017 for the Water Utility for the year ended December 31, 2017.

Inventories

Materials and supplies are generally used for construction, operation and maintenance work, not for resale. They are valued using the lower of moving average cost or market and charged to construction or expense when used. Fossil fuel inventory is valued at cost, using the last-in, first-out method.

Restricted Assets

Mandatory segregations of assets are presented as restricted assets. Such segregations are required by bond agreements and other external parties.

Other Current Assets

Prepaid expenses are recorded for insurance premiums and maintenance contracts related to computer equipment. Costs under these agreements are expensed over the time periods covered by the agreements.

Capital Assets

Capital assets are defined by the Utilities as assets with an initial, individual cost of \$5,000 or more, or group assets with a value of \$25,000 or more, and an estimated useful life in excess of one year.

Capital assets are recorded at cost or the estimated acquisition value at the time of contribution to RPU. Major outlays for capital assets are capitalized as projects are constructed. Interest incurred during the construction phase is reflected in the capitalized value of the assets constructed, net of interest earned on the invested proceeds over the same period. Capital assets in service are depreciated or amortized using the straight-line method over the following useful lives:

Electric Plant	Years
Generation	10-60
Transmission	20-45
Distribution	10-50
General	5-50
Water Plant	Years
Source of Supply	15-70
Pumping	10-50
Water Treatment	30-80
Transmission and Distribution	50-80
General	5-80

Other Assets – Noncurrent

Other Assets – Noncurrent includes Regulatory Assets consisting of Bond Issue Costs and Service Territory Acquisition Costs.

A summary of changes in electric other assets for 2017 follows:

	<u>Balance 1/1/17</u>	<u>Increases</u>	<u>Decreases</u>	<u>Balance 12/31/17</u>
Bond issue costs	\$1,778,227	\$647,188	\$105,472	\$2,319,943
Less: Amortization of bond issue costs	1,111,200	92,646	-	1,203,846
Nonoperating Other Assets	667,027			1,116,097
Regulatory asset-Service territory payments	16,403,209	310,980	-	16,714,189
Less: Amortization of Regulatory asset	4,833,596	419,967	-	5,253,563
Operating Other Assets	11,569,613			11,460,626
Net Other Assets	<u>\$12,236,640</u>			<u>\$12,576,723</u>

Deferred Outflows of Resources

The Electric Utility has issued revenue bonds to finance the advance and current refundings of the outstanding revenue bonds. The refundings resulted in a difference between the reacquisition price and net carrying amount of the old debt. This difference is being amortized and charged to operations over the bond term using the effective interest method. The unamortized balance as of December 31, 2017 is \$1,326,102.

Accrued Compensation and Compensated Absences

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

The Utilities' sick leave liability is estimated based on the Utilities' 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.

Customer Deposits

Customer deposits are recorded for security deposits paid by customers to receive utility services. Deposits are returned to customers with good credit history in accordance with criteria established in the Utilities' policies. Customers are paid interest on deposits at the rate established annually by the Minnesota Department of Commerce.

Unearned Revenues

Under the terms of a 2015 agreement, the Electric Utility constructed a substation to meet the specifications of a large customer. The customer paid a Contribution in Aid of Construction (CIAC) for redundant facilities for reliability purposes and for substation capacity in excess of current needs. Per the agreement, the customer can earn a refund of a portion of the CIAC related to excess capacity based on their measured load over the term from 2018 through 2027.

As of December 31, 2017, \$1,817,839 of the CIAC the customer had paid has been recorded as an Unearned Revenue which represents the amount of the potential refund related to excess capacity costs incurred as of that date. Starting in 2018, an annual determination will be made of whether or not the customer's measured load met the terms defined in the agreement in order to earn a refund. A portion of the excess capacity payment becomes ineligible for refund in each of those years if the load requirement specified in the agreement is not achieved. The amount of Unearned Revenue will be reduced each year through the ten year term, having either been refunded to the customer if load requirement has been met, or recorded as a Contribution in Aid of Construction if not met. The substation went in service in May, 2017.

As described in Note 11 under Legal Matters, the Electric Utility is engaged in an administrative hearing before the Federal Energy Regulatory Commission (FERC) involving the recovery of RPU's Annual Transmission Revenue Requirement (ATRR) from transmission customers in the Midcontinent Independent System Operator, Inc. region. The final resolution has not yet been determined however, as of December 31, 2017, RPU has received \$2,270,461 in ATRR payments. The payments are subject to refund if the FERC determines that RPU is not eligible for recovery of its ATRR. Until the final resolution is determined, RPU is recording the amounts received as Unearned Revenue.

As of December 31, 2017, customers had paid the Electric Utility \$14,400 as advances for construction of utility infrastructure which is reflected as Unearned Revenue. When the construction has been completed, such amounts will be recorded as Capital Contributions.

Long-Term Debt

Long-term debt and other obligations are reported as the Utilities' liabilities. Bond premiums and discounts are deferred and amortized over the life of the bonds using the effective interest method. Gains or losses on prior refundings are amortized over the remaining life of the old debt or the life of the new debt, whichever is shorter.

Deferred Inflows of Resources

The Electric Utility leases a portion of its transmission system, known as the North Loop, to Southern Minnesota Municipal Power Agency (SMMPA) under a noncancelable 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 annual lease revenues of \$36,420 are being recognized ratably over the lease term. The amount deferred as of December 31, 2017 was \$446,855.

The Water Utility has received advance payments for leasing antenna space on its water towers. The amount of advance payments held as of December 31, 2017 was \$220,964.

Pensions

For purposes of measuring the net pension liability, deferred outflows/inflows of resources, and pension expense, information about the fiduciary net position of the Public Employees Retirement Association of Minnesota (PERA) and additions to/deductions from PERA's fiduciary net position have been determined on the same basis as they are reported by PERA except that PERA's fiscal year end is June 30. For this purpose, plan contributions are recognized as of employer payroll paid dates and benefit payments and refunds are recognized when due and payable in accordance with the benefit terms. Investments are reported at fair value.

REVENUES AND EXPENSES

The Utilities distinguish operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with principal ongoing operations. The principal operating revenues of the Utilities are charges to customers for sales and services. Operating expenses include the cost of sales and services, administrative expenses, and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

Charges for Services

Billings are rendered and recorded monthly based on metered usage.

Current electric and water rates were approved by the Utility Board and the City Council and placed into effect on January 1, 2017.

Transfers

Transfers include the payment in lieu of taxes to the municipality and outgoing contributions in aid of construction when the payment is between the two utilities that comprise RPU.

Capital Contributions

Cash and capital assets are contributed to the Utilities from customers, the municipality or external parties. The value of property contributed to the Utilities is reported as revenues on the statement of revenues, expenses and changes in net position.

Significant Customers

Sales to the Electric Utility's largest customer were \$23,093,296 (\$18,674,492 Retail and \$4,418,804 Other) in 2017. No other customer accounted for more than 10% of the Electric Utility's operating revenues. No single customer accounted for more than 10% of the Water Utility's operating revenues.

EFFECT OF NEW ACCOUNTING STANDARDS ON CURRENT PERIOD FINANCIAL STATEMENTS

GASB has approved GASB Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*, Statement No. 83, *Certain Asset Retirement Obligations*, Statement No. 84, *Fiduciary Activities*, Statement No. 85, *Omnibus*, Statement No. 86, *Certain Debt Extinguishment Issues*, and Statement No. 87, *Leases*. When they become effective, application of these standards may restate portions of these financial statements.

NOTE 2: Deposits and Investments

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

The Utilities' 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, associated risks and fair value measurements are disclosed in the notes to the City of Rochester's basic financial statements included in the City's 2017 Comprehensive Annual Financial Report.

NOTE 3: Due to the Municipality

The following is a schedule of balances as of December 31, 2017:

<u>Due To</u>	<u>Due From</u>	<u>Principal Purpose</u>	<u>2017 Amount</u>
Municipality	Electric	General operating	\$95,879
Municipality	Electric	Payments in lieu of tax	692,236
Municipality	Electric	Sewer and Storm water revenue	2,841,762
Total Electric Due To Municipality			3,629,877
Electric	Municipality	Sewer and Storm water billing fees	145,688
Electric	Municipality	Utility bills	458,109
Electric	Municipality	Utility bill collections	1,280
Electric	Municipality	General operating	47,161
Electric	Municipality	Interest on investments	198,212
Total Electric Due From Municipality			850,450
Electric Net Due to Municipality			\$2,779,427
Municipality	Water	General operating	\$13,253
Municipality	Water	Street opening repairs	30,168
Municipality	Water	Payments in lieu of tax	25,148
Total Water Due To Municipality			68,569
Water	Municipality	Utility bills	9,964
Water	Municipality	General operating	5,362
Total Water Due From Municipality			15,326
Water Net Due to Municipality			\$53,243

The following is a schedule of transfer balances for the year ending December 31, 2017:

	<u>From</u>	<u>To</u>	<u>Principal Purpose</u>	<u>2017 Amount</u>
<u>ELECTRIC:</u>	Electric	Municipality	Tax Equivalents	\$8,421,844
	Electric	Water	Transfer Out - Capital Contributions	302,571
<u>WATER:</u>	Water	Municipality	Tax Equivalents	\$370,319
	Electric	Water	Transfer In - Capital Contributions	302,571

NOTE 4: Restricted Assets

Certain proceeds of the Utilities' revenue bonds, as well as certain resources set aside for their repayment, are classified as restricted assets on the statement of net position because their use is limited. The following accounts are reported as restricted assets on the electric utility:

2017

Current Assets

Debt Service Account

\$1,174,333

Used to segregate resources accumulated for debt service payments over the next twelve months.

Noncurrent Restricted Assets

Construction Fund

\$23,073,722

Under the provisions of the bond agreements and revenue notes, unspent proceeds are placed in a construction fund until capital expenditures are made.

Reserve Account

12,955,835

Proceeds deposited to be used to pay principal and interest payments on long-term debt.

Total Noncurrent Restricted Assets

\$36,029,557

NOTE 5: Changes in Capital Assets

ELECTRIC

A summary of changes in electric capital assets for 2017 follows:

	<u>Balance 1/1/17</u>	<u>Increases</u>	<u>Decreases</u>	<u>Balance 12/31/17</u>
Capital assets, not being depreciated:				
Construction in progress	\$33,713,148	\$51,768,605	\$9,206,944	\$76,274,809
Land and land rights	9,435,551	238,433	54,727	9,619,257
Total capital assets, not being depreciated	<u>43,148,699</u>	<u>52,007,038</u>	<u>9,261,671</u>	<u>85,894,066</u>
Capital assets, being depreciated:				
Buildings, structures and improvements	38,340,847	3,105,633	-	41,446,480
Installations, equipment and fixtures	331,687,048	15,612,140	4,814,985	342,484,203
Total capital assets, being depreciated	<u>370,027,895</u>	<u>18,717,773</u>	<u>4,814,985</u>	<u>383,930,683</u>
Less: Accumulated depreciation	<u>202,033,113</u>	<u>10,554,847</u>	<u>4,221,088</u>	<u>208,366,872</u>
Depreciable Assets, Net	<u>167,994,782</u>			<u>175,563,811</u>
Net Capital Assets	<u>\$211,143,481</u>			<u>\$261,457,877</u>

WATER

A summary of changes in water capital assets for 2017 follows:

	<u>Balance 1/1/17</u>	<u>Increases</u>	<u>Decreases</u>	<u>Balance 12/31/17</u>
Capital assets, not being depreciated:				
Construction in progress	\$3,670,970	\$1,595,588	\$3,615,691	\$1,650,867
Land and land rights	677,486	-	-	677,486
Total capital assets, not being depreciated	4,348,456	1,595,588	3,615,691	2,328,353
Capital assets, being depreciated:				
Buildings, structures and improvements	19,103,869	59,814	-	19,163,683
Installations, equipment and fixtures	118,588,741	6,429,552	266,933	124,751,360
Total capital assets, being depreciated	137,692,610	6,489,366	266,933	143,915,043
Less: Accumulated depreciation	46,254,030	2,639,588	126,763	48,766,855
Depreciable Assets, Net	91,438,580			95,148,188
Net Capital Assets	\$95,787,036			\$97,476,541

In 2017, capital assets totaling \$151,436 were contributed to the Utility by other funds of the City of Rochester, \$302,571 was contributed by the Electric Utility, and \$2,341,164 was contributed to the Utility by others.

NOTE 6: Long-Term Obligations**ELECTRIC**

The following revenue bonds have been issued:

Date	Purpose	Final Maturity	Interest Rate	Original Amount	Outstanding Amount 12/31/17
2/15/17	Revenue Bond Series 2017A-Westside Energy Station, Customer Service Center expansion, transmission and substation work, distribution system expansion, and refund remaining 2007C issue	12/1/47	2.00-5.00%	\$108,255,000	\$107,255,000
11/17/15	Revenue Bond Series 2015E-Advance refund a portion of the 2007C issue	12/1/30	3.00-5.00%	39,970,000	38,810,000
5/29/13	Revenue Bond Series 2013B-CapX2020 Southwest Metro to Rochester to La Crosse transmission line project	12/1/43	3.00-5.00%	38,370,000	36,300,000
3/19/07	Revenue Bond Series 2007C-Emission reduction equipment at Silver Lake Plant, transmission and substation work, distribution system expansion, and advance refund of Series 2000A Bonds	12/1/30	4.00-5.00%	76,680,000	-
4/19/16	Temporary Subordinate Revenue Bond Series 2016A	4/1/18	1.90%	20,850,000	-
2/26/13	Revenue Bond Series 2013A-Refund 2002 issue	12/1/17	2.00%	3,960,000	-

Revenue bond debt service requirements to maturity follows:

<u>Year Ending December 31</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2018	\$5,460,000	\$8,632,000	\$14,092,000
2019	5,725,000	8,366,350	14,091,350
2020	6,015,000	8,080,100	14,095,100
2021	6,315,000	7,779,350	14,094,350
2022	6,625,000	7,472,050	14,097,050
2023-2027	38,065,000	32,414,300	70,479,300
2028-2032	34,985,000	23,487,850	58,472,850
2033-2037	23,190,000	17,251,000	40,441,000
2038-2042	29,240,000	11,194,550	40,434,550
2043-2047	26,745,000	3,897,500	30,642,500
	<u>\$182,365,000</u>	<u>\$128,575,050</u>	<u>\$310,940,050</u>

All utility revenues net of specified operating expenses are pledged as security of the above revenue bonds until the bonds are paid off. Principal and interest paid for 2017 was \$56,123,310, which consisted of \$11,628,310 of scheduled principal and interest payments, \$20,850,000 to refund the US Bank credit facility, and \$23,645,000 to refund the outstanding portion of the 2007C bond issue. Total gross revenues as defined for the same period were \$161,631,346. Annual principal and interest payments are expected to require 6% of gross revenues on average.

On April 19, 2016, a temporary subordinate revenue bond in the amount of \$25.0 million was issued in the form of a credit facility, or tax-exempt draw-down loan with U.S. Bank, at an average interest rate of 1.00%. The purpose of this borrowing was to provide temporary financing for the Westside Energy Station until permanent financing could be obtained in 2017. At the time of that financing, \$20,850,000 had been drawn down and was rolled into the permanent borrowing.

On February 15, 2017, bonds in the amount of \$108.3 million were issued with an average interest rate of 4.90% to finance the Westside Energy Station, Service Center expansion and renovation, transmission and substation work, and distribution system expansion, as well as to refund a \$20.85 million credit facility and \$23.645 million of outstanding bonds with an average interest rate of 4.57%. The cash flow requirements on the old bonds prior to the refunding were \$32,290,117 from 2017 through 2030. The cash flow requirements on the new bonds are \$28,405,415. The current refunding resulted in an economic gain of \$2,933,357.

LONG-TERM OBLIGATIONS SUMMARY – ELECTRIC

Long-term obligation activity for the year ended December 31, 2017 is as follows:

	<u>1/1/17 Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>12/31/17 Balance</u>	<u>Due Within One Year</u>
Long-term debt	\$114,790,000	\$115,755,000	\$48,180,000	\$182,365,000	\$5,460,000
Bond discount/premium	8,300,448	17,337,816	2,504,468	23,133,796	-
Accrued Compensated Absences	2,683,906	264,895	39,801	2,909,000	1,659,179
Pre-1968 Pension Liability	8,000	-	2,000	6,000	-
Net Pension Liability	17,900,174	-	2,839,508	15,060,666	-
Unearned Revenue	-	4,137,567	34,867	4,102,700	-
Totals	<u>\$143,682,528</u>	<u>\$137,495,278</u>	<u>\$53,600,644</u>	<u>\$227,577,162</u>	<u>\$7,119,179</u>

LONG-TERM OBLIGATIONS SUMMARY – WATER

Long-term obligation activity for the year ended December 31, 2017 is as follows:

	<u>1/1/17 Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>12/31/17 Balance</u>	<u>Due Within One Year</u>
Accrued Compensated Absences	\$438,674	\$42,805	\$33,169	\$448,310	\$255,406
Net Pension Liability	2,105,210	-	348,431	1,756,779	-
Totals	<u>\$2,543,884</u>	<u>\$42,805</u>	<u>\$381,600</u>	<u>\$2,205,089</u>	<u>\$255,406</u>

INTEREST EXPENSE – ELECTRIC

	<u>2017</u>
Bond interest expense	\$8,208,647
Bond premium, discount & refunding amortization	(1,875,613)
Interest expense	27,558
Allowance for funds used during construction	(1,414,316)
Totals	<u>\$4,946,276</u>

NOTE 7: Net Position

GASB Statement No. 34 requires the classification of net position into three components – net investment in capital assets, restricted, and unrestricted. These classifications are defined as follows:

NET INVESTMENT IN CAPITAL ASSETS

This component of net position consists of capital assets, net of accumulated depreciation, reduced by the outstanding balances of bonds, mortgages, notes, or other borrowings that are attributable to the acquisition, construction, or improvement of those assets. Deferred outflows of resources and deferred inflows of resources that are attributable to the acquisition, construction, or improvement of those assets or related debt are included in this component of net position. If there are significant unspent related debt proceeds or deferred inflows of resources at the end of the reporting period, the portion of the debt or deferred inflows of resources attributable to the unspent amount are not included in the calculation of net investment in capital assets. Instead, that portion of the debt or deferred inflows of resources are included in the same net position component (restricted or unrestricted) as the unspent amount.

RESTRICTED

This component of net position consists of restricted assets reduced by liabilities and deferred inflows of resources related to those assets. Generally, a liability relates to restricted assets if the asset results from a resource flow that also results in the recognition of a liability or if the liability will be liquidated with the restricted assets reported.

UNRESTRICTED

This component of net position is the net amount of the assets, deferred outflows of resources, liabilities, and deferred inflows of resources that are not included in the determination of net investment in capital assets or the restricted component of net position.

NOTE 8: Pension Plans

A. Plan Description

The Utilities, as departments of the City of Rochester, participate in the General Employees Retirement Fund (GERF) cost-sharing multiple-employer defined benefit pension plan administered by the Public Employees Retirement Association of Minnesota (PERA). PERA's defined benefit pension plans are established and administered in accordance with Minnesota Statutes, Chapters 353 and 356. PERA's defined benefit pension plans are tax qualified plans under Section 401 (a) of the Internal Revenue Code.

All full-time and certain part-time employees of the Utilities are covered by the General Employees Plan. General Employees Plan members belong to either the Coordinated Plan or the Basic Plan. Coordinated Plan members are covered by Social Security and Basic Plan members are not. The Basic Plan was closed to new members in 1967. All new members must participate in the Coordinated Plan. All of RPU's current employees eligible to participate in the GERF are Coordinated Plan members.

B. Benefits Provided

PERA provides retirement, disability, and death benefits. Benefit provisions are established by state statute and can only be modified by the state legislature.

Benefit increases are provided to benefit recipients each January. Increases are related to the funding ratio of the plan. Members in a plan that are at least 90% funded for two consecutive years are given a 2.5% increase. Members in a plan that has not exceeded 90% funded, or has fallen below 80%, are given a 1% increase.

The benefit provisions stated in the following paragraph of this section are current provisions and apply to active plan participants. Vested, terminated employees who are entitled to benefits but are not receiving them yet are bound by the provisions in effect at the time they last terminated their public service.

Benefits are based on a member's highest average salary for any five successive years of allowable service, age, and years of credit at termination of service. Two methods are used to compute benefits for PERA's Coordinated Plan members. The retiring member receives the higher of a step-rate benefit accrual formula (Method 1) or a level accrual formula (Method 2). Under Method 1, the annuity accrual rate for a Coordinated Plan member is 1.2% of

average salary for each of the first ten years and 1.7% for each remaining year. Under Method 2, the annuity accrual rate is 1.7% for Coordinated Plan members for each year of service. For members hired prior to July 1, 1989 a full annuity is available when age plus years of service equal 90 and normal retirement age is 65. For members hired on or after July 1, 1989 normal retirement age is the age for unreduced Social Security benefits capped at 66.

C. Contributions

Minnesota Statutes Chapter 353 sets the rates for employer and employee contributions. Contribution rates can only be modified by the state legislature.

Coordinated Plan members were required to contribute 6.5% of their annual covered salary in calendar year 2017. The Utilities were required to contribute 7.5% for Coordinated Plan members in calendar year 2017. The Utilities' contributions to the GERP for the year ended December 31, 2017, were \$1,123,064 and \$131,642 for the Electric Utility and Water Utility respectively. The Utilities' contributions were equal to the required contributions as set by state statute.

D. Pension Costs

At December 31, 2017, the Electric Utility reported a liability of \$15,060,666, and the Water Utility reported a liability of \$1,756,779 as each utility's allocated share of the City of Rochester's proportionate share of \$49,162,676 of the GERP's net pension liability. The City of Rochester's net pension liability reflected a reduction due to the State of Minnesota's contribution of \$6 million to the fund in 2017. The State of Minnesota is considered a nonemployer contributing entity and the state's contribution meets the definition of a special funding situation. The State of Minnesota's proportionate share of the net pension liability associated with the City of Rochester totaled \$618,213. The net pension liabilities were measured as of June 30, 2017 and the total pension liabilities used to calculate the net pension liabilities were determined by an actuarial valuation as of that date. The City of Rochester's net pension liability was based on the City's contributions received by PERA during the measurement period for employer payroll paid dates from July 1, 2016, through June 30, 2017, relative to the total employer contributions received from all of PERA's participating employers. At June 30, 2017, the City's proportionate share was 0.7701% which was an increase of 0.0430% from its proportion measured as of June 30, 2016.

For the year ended December 31, 2017, the Electric Utility and Water Utility recognized pension expense of \$2,226,691 and \$244,216 respectively as allocated shares of the City of Rochester's GERP pension expense.

At December 31, 2017, the Electric Utility reported its allocated share of the City of Rochester's GERP deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

	<u>Deferred Outflows of Resources</u>	<u>Deferred Inflows of Resources</u>
Differences between expected and actual economic experience	\$496,354	\$909,712
Changes in actuarial assumptions	2,336,580	1,509,833
Difference between projected and actual investment earnings	2,494,597	2,557,186
Changes in proportion	802,173	369,433
Contributions paid to PERA subsequent to the measurement date	569,036	-
Total	\$6,698,740	\$5,346,164

\$569,036 reported as deferred outflows of resources related to pensions resulting from Electric Utility contributions subsequent to the measurement date will be recognized as a reduction of the net pension liability in the year ended December 31, 2018. Other amounts reported as deferred outflows and inflows of resources related to pensions will be recognized in pension expense as follows:

Year ended December 31:	Pension Expense Amount
2018	\$514,725
2019	971,258
2020	(63,147)
2021	(639,296)

At December 31, 2017, the Water Utility reported its allocated share of the City of Rochester's GERS deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

	<u>Deferred Outflows of Resources</u>	<u>Deferred Inflows of Resources</u>
Differences between expected and actual economic experience	\$57,898	\$107,359
Changes in actuarial assumptions	274,801	176,117
Difference between projected and actual investment earnings	294,424	298,287
Changes in proportion	93,571	43,935
Contributions paid to PERA subsequent to the measurement date	64,571	-
Total	\$785,265	\$625,698

\$64,571 reported as deferred outflows of resources related to pensions resulting from Water Utility contributions subsequent to the measurement date will be recognized as a reduction of the net pension liability in the year ended December 31, 2018. Other amounts reported as deferred outflows and inflows of resources related to pensions will be recognized in pension expense as follows:

Year ended December 31:	Pension Expense Amount
2018	\$60,882
2019	115,430
2020	(6,744)
2021	(74,572)

E. Actuarial Assumptions

The total pension liability in the June 30, 2017, actuarial valuation was determined using the following actuarial assumptions:

Inflation	2.50% per year
Active Member Payroll Growth	3.25% per year
Investment Rate of Return	7.50%

Salary increases were based on a service-related table. Mortality rates for active members, retirees, survivors and disabilitants were based on RP 2014 tables for males or females, as appropriate, with slight adjustments to fit PERA’s experience. Cost of living benefit increases for retirees are assumed to be 1% per year through 2044 and then 2.5% thereafter.

Actuarial assumptions used in the June 30, 2017, valuation were based on the results of actuarial experience studies. The most recent four-year experience study in the General Employees Plan was completed in 2015.

The following changes in actuarial assumptions occurred in 2017:

- The Combined Service Annuity (CSA) loads were changed from 0.8% for active members and 60% for vested and nonvested deferred members. The revised CSA loads are now 0% for active member liability, 15% for vested deferred member liability and 3% for nonvested deferred member liability.
- The assumed post-retirement benefit increase rate was changed from 1% per year for all years to 1% per year through 2044 and 2.5% per year thereafter.

The State Board of Investment, which manages the investments of PERA, prepares an analysis of the reasonableness on a regular basis of the long-term expected rate of return using a building-block method in which best-estimate ranges of expected future rates of return are developed for each major asset class. These ranges are combined to produce an expected long-term rate of return by weighting the expected future rates of return by the target asset allocation percentages. The target allocation and best estimates of geometric real rates of return for each major asset class are summarized in the following table:

Asset Class	Target Allocation	Long-Term Expected Real Rate of Return
Domestic Stocks	39%	5.10%
International Stocks	19%	5.30%
Bonds	20%	0.75%
Alternative Assets	20%	5.90%
Cash	2%	0.00%
Total	100%	

F. Discount Rate

The discount rate used to measure the total pension liability in 2017 was 7.5%. The projection of cash flows used to determine the discount rate assumed that contributions from plan members and employers will be made at rates set in Minnesota Statutes. Based on these assumptions, the fiduciary net position of the General Employees Fund was projected to be available to make all projected future benefit payments of current plan members. Therefore, the long-term expected rate of return on pension plan investments was applied to all periods of projected benefit payments to determine the total pension liability.

G. Pension Liability Sensitivity

The following presents the Electric Utility's and Water Utility's allocated shares of the City of Rochester's net pension liability for the GERP plan participated in, calculated using the discount rate disclosed in the preceding paragraph, as well as what the each utility's allocated share of the net pension liability would be if it were calculated using a discount rate 1 percentage point lower or 1 percentage point higher than the current discount rate:

	1% Decrease in Discount Rate (6.5%)	Current Discount Rate (7.5%)	1% Increase in Discount Rate (8.5%)
Electric Utility's allocated share of the GERP net pension liability:	\$23,360,212	\$15,060,666	\$8,265,980
Water Utility's allocated share of the GERP net pension liability:	\$2,724,894	\$1,756,779	\$964,200

H. Pension Plan Fiduciary Net Position

Detailed information about each pension plan's fiduciary net position is available in a separately-issued PERA financial report that includes financial statements and required supplementary information. That report may be obtained on the Internet at www.mnpera.org.

I. Other Pension Plans

The Utilities 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, 2017 was \$32,525.

NOTE 9: Risk Management

The Utilities are exposed to various risks of loss related to torts, theft of, damage to, or destruction of assets, errors and omissions. These risks are covered through the purchase of commercial insurance, with minimal deductibles. Settled claims have not exceeded the commercial liability in any of the past three years. There were no significant reductions in coverage compared to the prior year.

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 \$315,000 per claim with a \$190,000 aggregating specific deductible and variable annual aggregate, and the 2017 workers' compensation coverage is limited to \$1,000,000 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. Additional details regarding the self-insurance program are disclosed in the notes to the City of Rochester's basic financial statements included in the City's 2017 Comprehensive Annual Financial Report.

NOTE 10: Accounting for the Effects of Rate Regulation

The Utilities are subject to the provisions of GASB Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 10, 1989 FASB and AICPA Pronouncements*. This statement recognizes the economic ability of regulators, through the ratemaking process, to create future economic benefits and obligations affecting rate-regulated entities. Accordingly, the Utilities record these future economic benefits and obligations as regulatory assets and regulatory liabilities respectively.

Regulatory assets represent probable future revenues associated with previously incurred costs that are expected to be recovered from customers. Regulatory liabilities represent probable future reductions in revenues associated with amounts that are expected to be refunded to customers through the ratemaking process.

In order for a rate-regulated entity to continue to apply the provisions of GASB Statement No. 62, it must continue to meet the following three criteria:

1. The entities' rates for regulated services provided to its customers must be established by an independent third-party regulator or its own governing board empowered by a statute to establish rates that bind customers;
2. The regulated rates must be designed to recover the specific entities' costs of providing the regulated services;
3. In view of the demand for the regulated services and the level of competition, it is reasonable to assume that rates set at levels that will recover the entities' costs can be charged to and collected from customers.

Based upon the Utilities' management evaluation of the three criteria discussed above in relation to its operations, and the effect of competition on its ability to recover its costs, the Utilities believe that GASB Statement No. 62 continues to apply.

NOTE 11: Commitments and Contingencies

POWER SALES AGREEMENT

The Electric Utility has a Resource Management Agreement with The Energy Authority, Inc. as its market participant in the Midcontinent Independent System Operator energy and operating reserves market for the Cascade Creek combustion turbines.

SERVICE TERRITORY SETTLEMENTS

Under settlement agreements with People's Energy Cooperative (PEC), the Electric Utility is required to make payments to PEC related to the acquisitions of certain electric service rights from PEC. The payment is based on kilowatt hours (kWh) sold in acquired areas and varies by each settlement agreement. The kWh compensation rate ranges from 13.82 mills (tenths of a cent) per kWh to 16.51 mills per kWh. These commitments expire over various periods with a maximum term of ten years for each acquisition. Costs are recognized under these agreements as service is provided and are recorded as a regulatory asset for utility rate-making purposes under the provisions of GASB Statement No. 62 and amortized over 40 years.

SOUTHERN MINNESOTA MUNICIPAL POWER AGENCY

The Electric 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 1,213,883,068 kilowatt hours totaling \$92,254,159 from SMMPA during the year ended December 31, 2017.

The Utility leases a portion of its electrical transmission system, known as the North Loop, to SMMPA under a noncancelable 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 annual lease revenues of \$36,420 are being recognized ratably over the lease term.

CENTRAL MINNESOTA MUNICIPAL POWER AGENCY

The Electric Utility has an agreement with Central Minnesota Municipal Power Agency (CMMPA) for the purchase of capacity. The remaining contract quantities and prices are as follows:

Planning Year	Megawatts (per month)	Contract Price (\$ per MW)	Purchase Price
June 1, 2017-May 31, 2018	4	\$1,900	\$91,200
June 1, 2018-May 31, 2019	8	\$2,400	\$230,400
June 1, 2019-May 31, 2020	11	\$2,900	\$382,800
June 1, 2020-May 31, 2021	11	\$3,400	\$448,800
June 1, 2021-May 31, 2022	11	\$4,000	\$528,000

WESTSIDE ENERGY STATION

Construction of the Westside Energy Station began in October, 2016. It is comprised of five reciprocating gas engines driving generators with a total capacity of 46MW at an expected project cost of \$68 million. The quick responding, highly efficient natural gas powered generating station will provide for future capacity needs and support system reliability. As more intermittent renewable generation is added to the regional grid, quick responding generating units such as this are critical to ensure grid stability. Work prior to construction included acquiring the necessary permits, purchasing the engines, executing an engineer, procure, and construct (EPC) contract with Westside Energy Partners (a collaboration between Sargent & Lundy and Boldt Construction), and performing detailed design. Substantial completion was accomplished in December 2017. Commercial operation began March 20, 2018.

LAKE ZUMBRO RESTORATION

Lake Zumbro is a reservoir on the Zumbro River formed by the Zumbro Dam which was placed in service in 1919. RPU is the owner and operator of the Zumbro Dam & Hydroelectric Facility and owns in fee title much of the lake bed. Over the years sedimentation has filled in portions of the lake. In December, 2015, RPU along with Olmsted County, Wabasha County, and the Lake Zumbro Improvement District executed an agreement where each party committed to providing funding that in total matched \$3,500,000 committed by the State of Minnesota to dredge sediment from portions of the lake. RPU's committed amount is \$1,167,000. Olmsted County is acting as the project manager and fiscal agent for the parties committed in the agreement. As of December 31, 2017, RPU had provided \$48,282 in funding leaving a committed balance of \$1,118,718. Funding by RPU occurs only as project expenditures are incurred.

OPEN CONSTRUCTION CONTRACTS AND OTHER SIGNIFICANT COMMITMENTS

The Utilities have several active projects and agreements as of December 31, 2017. At year end, the Utilities' significant commitments are as follows:

<u>Electric Projects</u>	<u>Spent-to-Date</u>	<u>Remaining Commitment</u>
Westside Energy Station	\$60,674,170	\$1,701,011
CapX2020	40,581,353	142,186
Customer Billing and Payments	2,005,259	1,699,628
Cayenta Implementation	1,825,070	527,858
Building Expansion	710,668	9,413,526
Directional Boring	516,826	1,183,174
Communication Systems	165,371	340,551
Cascade Creek Transformer Replacement	112,400	853,429
Stock Materials	5,677	318,775
Tree trimming	-	384,977
<u>Water Projects</u>	<u>Spent-to-Date</u>	<u>Remaining Commitment</u>
Engineering & Consulting	29,201	145,256
Water Sustainability Study	5,850	62,550
Booster Pump Replacement	-	21,200

LEGAL MATTERS

The Electric Utility is engaged in an administrative hearing before the Federal Energy Regulatory Commission involving the recovery of RPU's Annual Transmission Revenue Requirement from transmission customers in the Midcontinent Independent System Operator, Inc. region. It does not involve a claim or assessment against RPU. It is not presently expected that the outcome of this matter, when resolved, will have a material adverse impact on the financial position of the Electric Utility.

CLAIMS AND JUDGMENTS

From time to time, the Utilities are party to various pending claims and legal proceedings. Although the outcome of such matters cannot be forecasted with certainty, it is the opinion of management and the Utilities' attorney that the likelihood is remote that any such claims or proceedings will have a material adverse effect on the Utilities' financial position or results of operations.

NOTE 12: Subsequent Events

In November 2017, the Utility Board and the City Council approved a 1.5% overall rate increase for the Electric Utility effective January 1, 2018.

In November 2015, the Utility Board and the City Council approved rate schedules to be effective January 1, 2016, 2017 and 2018 for the Water Utility. The general increase is 6.0% each year.

On January 30, 2018, the RPU Board of Directors approved executing a contract between the RPU Water Utility and Macqueen Equipment for \$270,622, plus applicable taxes for a 2019 Freightliner M2 with a Vactor HXX Paradigm® vacuum excavator body. This compact, multi-use truck will be used primarily for water main breaks.

On March 27, 2018, the RPU Board of Directors approved executing a contract between the RPU Water Utility and M.K. Painting for \$239,500 for repairing and repainting the Bandel Reservoir water storage tank. The work is to be completed in 2018.

On March 27, 2018, the RPU Board of Directors approved RPU Electric Utility purchasing the Microsoft license renewal through SHI International Corp, in an amount not to exceed \$550,000, plus applicable taxes for a three-year term (March 1, 2018 through February 28, 2021).

In preparing these financial statements, Rochester Public Utilities has evaluated events and transactions for potential recognition or disclosure through March 30, 2018, the date the financial statements were available to be issued.

REQUIRED SUPPLEMENTARY INFORMATION (unaudited)

As of and for the Year Ended December 31, 2017

The Schedule of Employer Contributions shows the employer's required annual contributions from the annual actuarial valuation, compared with the actual contributions remitted over the past ten years.

Schedule of Rochester Public Utilities – Electric Utility Contributions Public Employees General Employees Retirement Fund Required Supplementary Information (Last Ten Years*)

Fiscal Year Ending (for the Financial Reporting Period)	Statutorily Required Contribution (a)	Contributions in Relation to the Statutorily Required Contribution (b)	Contribution Deficiency (Excess) (a-b)	Covered-Employee Payroll (d)	Contributions as a Percentage of Covered-Employee Payroll (b/d)
December 31, 2015	\$1,053,611	\$1,053,611	\$ -	\$14,048,147	7.5%
December 31, 2016	\$1,047,623	\$1,047,623	\$ -	\$13,968,307	7.5%
December 31, 2017	\$1,123,064	\$1,123,064	\$ -	\$14,974,187	7.5%

*This schedule is presented prospectively beginning with the fiscal year ended December 31, 2015.

Schedule of Rochester Public Utilities – Water Utility Contributions Public Employees General Employees Retirement Fund Required Supplementary Information (Last Ten Years*)

Fiscal Year Ending (for the Financial Reporting Period)	Statutorily Required Contribution (a)	Contributions in Relation to the Statutorily Required Contribution (b)	Contribution Deficiency (Excess) (a-b)	Covered-Employee Payroll (d)	Contributions as a Percentage of Covered-Employee Payroll (b/d)
December 31, 2015	\$125,932	\$125,932	\$ -	\$1,679,093	7.5%
December 31, 2016	\$125,295	\$125,295	\$ -	\$1,670,600	7.5%
December 31, 2017	\$131,642	\$131,642	\$ -	\$1,755,227	7.5%

*This schedule is presented prospectively beginning with the fiscal year ended December 31, 2015.

See accompanying *Independent Auditors' Report* and accompanying *Note to the Required Supplementary Information*.

**Schedule of Rochester Public Utilities – Electric Utility Proportionate Share of Net Pension Liability
Public Employees General Employees Retirement Fund
Required Supplementary Information (Last Ten Years*)**

Fiscal Year Ending (for the Measurement Period)	City of Rochester's Proportion (Percentage) of Net Pension Liability (Asset)	RPU Electric Utility's Allocated Share (Amount) of the Net Pension Liability (Asset) (a)	RPU Electric Utility's Covered-Employee Payroll (b)	RPU Electric Utility's Allocated Share of the Net Pension Liability (Asset) as a Percentage of its Covered-Employee Payroll (a/b)	Plan Fiduciary Net Position as a Percentage of the Total Pension Liability
June 30, 2015	0.7410%	\$11,722,132	\$13,004,761	90.14%	78.19%
June 30, 2016	0.7271%	\$17,900,174	\$13,124,826	136.38%	68.91%
June 30, 2017	0.7701%	\$15,060,666	\$13,811,891	109.04%	75.90%

**Schedule of Rochester Public Utilities – Water Utility Proportionate Share of Net Pension Liability
Public Employees General Employees Retirement Fund
Required Supplementary Information (Last Ten Years*)**

Fiscal Year Ending (for the Measurement Period)	City of Rochester's Proportion (Percentage) of Net Pension Liability (Asset)	RPU Water Utility's Allocated Share (Amount) of the Net Pension Liability (Asset) (a)	RPU Water Utility's Covered-Employee Payroll (b)	RPU Water Utility's Allocated Share of the Net Pension Liability (Asset) as a Percentage of its Covered-Employee Payroll (a/b)	Plan Fiduciary Net Position as a Percentage of the Total Pension Liability
June 30, 2015	0.7410%	\$1,400,562	\$1,512,163	92.62%	78.19%
June 30, 2016	0.7271%	\$2,105,210	\$1,582,656	133.02%	68.91%
June 30, 2017	0.7701%	\$1,756,779	\$1,646,190	106.72%	75.90%

See accompanying *Independent Auditors' Report* and accompanying *Note to the Required Supplementary Information*.

NOTE TO THE REQUIRED SUPPLEMENTARY INFORMATION

As of and for the Year Ended December 31, 2017

NOTE 1: General Employees Retirement Fund (GERF) administered by the Public Employees Retirement Association of Minnesota (PERA)

The amounts determined for each fiscal year were determined as of the calendar year-end that occurred within the fiscal year. The City of Rochester is required to present the last ten fiscal years of data; however accounting standards allow the presentation of as many year as are available until ten fiscal years are presented.

There were no changes of benefit terms for any participating employer in the GERF.

The following changes in actuarial assumptions occurred in 2017:

- The Combined Service Annuity (CSA) loads were changed from 0.8% for active members and 60% for vested and nonvested deferred members. The revised CSA loads are now 0% for active member liability, 15% for vested deferred member liability and 3% for nonvested deferred member liability.
- The assumed post-retirement benefit increase rate was changed from 1% per year for all years to 1% per year through 2044 and 2.5% per year thereafter.

OPERATING AND FINANCIAL STATISTICS (unaudited)

ELECTRIC

	2017	2016	2015	2014	2013	2008 <i>(ten years ago)</i>
RETAIL CUSTOMERS:						
Residential	49,323	48,426	46,961	46,035	45,651	42,861
General Service	4,904	4,862	4,807	4,759	4,725	4,540
Industrial / Commercial	2	2	2	2	2	2
Other	4	4	4	4	4	4
Total Retail Customers	54,233	53,294	51,774	50,800	50,382	47,407
RETAIL SALES: (mWh)						
Residential	339,825	346,974	335,708	341,452	348,952	328,030
General Service	645,765	653,742	644,067	637,360	641,210	640,711
Industrial / Commercial	187,572	194,520	205,164	212,297	225,082	306,828
Other	14,686	14,770	14,453	15,252	15,442	15,534
Total Retail Sales (mWh)	1,187,848	1,210,006	1,199,392	1,206,361	1,230,686	1,291,103
RETAIL REVENUE:						
Residential	\$49,179,998	\$46,886,573	\$44,025,807	\$42,818,865	\$42,344,833	\$37,790,777
General Service	72,689,236	69,181,817	66,051,022	63,734,518	62,342,255	57,912,677
Industrial / Commercial	18,971,304	18,212,053	18,227,249	18,277,321	18,562,734	21,159,879
Other	5,938,292	7,730,497	5,256,387	5,617,573	5,614,439	4,544,124
Total Retail Revenue	\$146,778,830	\$142,010,940	\$133,560,465	\$130,448,277	\$128,864,261	\$121,407,457
Steam Sales (MLBs)	439,864	453,699	441,791	424,402	451,945	346,449
Steam Revenues	\$4,418,805	\$4,038,836	\$5,412,228	\$6,743,606	\$4,849,550	\$3,771,825
Annual Peak (Megawatts)	266.2	276.2	262.0	258.7	278.6	270.4
Total mWh Generated	38,968	55,396	47,384	20,770	75,775	231,848
Total mWh Purchased	1,216,551	1,239,832	1,226,956	1,237,135	1,255,701	1,324,665
Year End Restricted/ Unrestricted Cash & Investment Balance	\$94,046,678	\$46,453,195	\$51,201,139	\$60,598,748	\$76,101,705	\$40,265,406

WATER

	2017	2016	2015	2014	2013	2008 <i>(ten years ago)</i>
RETAIL CUSTOMERS:						
Residential	36,134	35,736	35,332	34,871	34,571	33,044
Industrial / Commercial	3,614	3,578	3,501	3,459	3,463	3,369
Total Retail Customers	39,748	39,314	38,833	38,330	38,034	36,413
RETAIL SALES: (ccf)						
Residential	2,713,284	2,654,992	2,675,696	2,792,307	2,863,062	3,070,783
Industrial / Commercial	3,061,222	3,073,274	2,763,972	2,689,861	2,797,590	2,995,159
Total Retail Sales (ccf)	5,774,506	5,728,266	5,439,668	5,482,168	5,660,652	6,065,942
RETAIL REVENUE:						
Residential	\$5,189,102	\$4,768,468	\$4,385,870	\$4,283,619	\$4,286,290	\$4,221,429
Industrial / Commercial	3,409,516	3,236,888	2,806,087	2,647,654	2,684,057	2,750,234
Public Fire Protection	522,724	513,738	596,323	571,535	558,113	536,192
Total Retail Revenue	\$9,121,342	\$8,519,094	\$7,788,280	\$7,502,808	\$7,528,460	\$7,507,855
Total Pumped (billion gallons)	4.5	4.5	4.3	4.4	4.5	4.8
Year End Restricted/ Unrestricted Cash & Investment Balance	\$7,122,783	\$5,705,448	\$4,918,129	\$5,747,264	\$6,569,559	\$5,332,076

LEADERSHIP



Mark Kotschevar
General Manager



Sidney Jackson
*Director of
Core Services*



Peter Hogan
*Director of
Corporate Services*



Steve Nyhus
*Director of
Compliance and
Public Affairs*



Walter Schlink
*Director of
Power Resources/
Customer Relations*

UTILITY BOARD



Mark Browning
Board President
*Senior Project Manager,
Facilities Project
Services*
– Mayo Clinic



Brian Morgan
Board Member
*Professional
Engineer*
– Kerry



Tim Haskin
Board Member
*Director,
Sales Consulting*
– Sabre Technologies/
PRISM Group



**Melissa
Graner Johnson**
Board Member
*Trust Relationship
Manager*
– U.S. Bank



Michael Wojcik
*Board Member &
City Council Liaison*
*Owner – Elite
Consulting, Inc.;*
City Council Member
– City of Rochester

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