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# **SUPPORTING GROWTH**

**2018 ANNUAL REPORT**



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Cover Photo By Josh Banks

## 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, 2018, 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, 2018, 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, 2018, 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 29, 2019 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 29, 2019

# MANAGEMENT'S 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, 2018 compared to the year ended December 31, 2017.*

*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, liabilities and deferred inflows of resources, 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.

### Required Supplemental Information

The required supplemental information provides historical information about RPU's defined benefit pension plans including changes in the net pension liabilities, annual contributions made to the pension plans, and changes in plan provisions and actuarial assumptions.

See accompanying *Independent Auditors' Report*.

## HIGHLIGHTS

- Rochester continued to grow with 1,102 new electric customers and 451 new water customers added in 2018. This compares with growth of 939 electric customers and 434 water customers in 2017.
- Electric retail revenues were up \$5.1 million or 3.5% over 2017, along with an increase in kilowatt-hour sales of 17.2 million or 1.5%. The majority of the increase in revenues was due to a 1.5% overall rate increase effective January 1, 2018, combined with the increase in kilowatt-hour sales. The annual system peak demand of 277 megawatts was set in July, and compares with a peak demand of 266 megawatts in 2017 and the all-time system peak demand of 292 megawatts in 2011.
- Water retail revenues were up \$0.5 million or 5.3% over 2017, while sales volume was down 156,000 ccf (hundred cubic feet) or 2.7%. The increase in revenues was due to a 6.0% rate increase effective January 1, 2018 offset by the decrease in sales volume.
- An Electric Utility cost-of-service study was completed in 2017, with a two-year rate track presented for 2018 and 2019. The Utility Board elected to approve a one-year increase of 1.5% for 2018, which was also approved by the City Council. The increase was effective January 1, 2018. A Water Utility cost-of-service study was completed in 2015, with the Utility Board voting for and City Council approving a three-year rate track covering 2016 through 2018. The third year's rate increase of 6.0% was effective January 1, 2018. 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 remained the same in 2018. Purchased power costs from SMMPA and the Midcontinent Independent System Operator (MISO) market represented 67% of electric operating expenses for 2018.
- The construction phase of the \$12.5 million expansion and renovation of the thirty year old Service Center facility began in late 2017, and continued throughout 2018. The expansion and renovation addresses 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. At the end of 2018, four of the five major phases of construction were substantially complete, and occupancy is scheduled for early 2019.
- Work continued in 2018 on the new customer service and billing system implementation project, with a 2019 go-live expected. The new software system will improve customer self-service options and provide real-time applications and field mobility capabilities, along with realizing savings over the current vendor. In tandem with the customer service and billing system implementation, a new communications platform will enhance customer self-service options and proactive communications with customers.

See accompanying *Independent Auditors' Report*.

- The Westside Energy Station (WES), located on a 50-acre site on the west side of Rochester, began commercial operation in late March and has exceeded initial projections. WES has participated in the MISO day ahead and real time energy markets, along with the ancillary services market. From April 1 to December 31, 2018, the station has run 1,689 hours generating 57.3 million kWh with an associated capacity factor of 18.9%. In addition to providing energy and capacity, WES has blackstart capability that can be utilized in emergency situations. The prime movers at WES are reciprocating internal combustion engines driving generators with a combined output of 46 megawatts.
- Asset management is a widely accepted industry practice through which capital assets are inventoried, monitored, maintained over time, and ultimately prioritized for replacement, and is one of several tools to manage aging infrastructure. Understanding and managing an asset's condition leads to better repair, rehabilitation, or replacement decisions, and better control of related financial decisions. In 2018, Engineering and Technical Services staff, along with assistance from outside consultants, began organizing maintenance and condition assessment information for substation apparatus such as power transformers, station batteries, and switchgear. Work has begun to apply asset management practices to distribution assets such as poles and underground cable as well.
- In 2018, RPU began working with a consultant to develop a Water Main Replacement Prioritization Plan. The plan analyzed data on the water distribution system to develop an overall risk score for each segment of water main in the system. A capital improvement plan was developed based on the highest risk scores. RPU continues to work with Rochester Public Works to incorporate water main capital improvement plans developed through this study into mutually beneficial projects that will address a combination of needs for both RPU and Rochester Public Works
- In 2018, the Utility Board prioritized an initiative to study ways to support conservation, decreased CO2 emissions through efficient electrification, and the willingness of our customers to change their electric use behaviors to achieve these goals. A key component of this study is evaluating current and alternative rate structures. An educational forum was held in July to inform both the Board and the public on the current rate design as well as other rate design options and considerations for each. The Board then held a study session in October to further explore several different rate designs and their advantages and disadvantages. Research will continue during 2019 with the intent of setting a long term strategy to achieve our environmental goals.
- RPU surpassed its Aggressive Demand-Side Management (DSM) goal for 2018 of 18,307 megawatt hours in energy savings. Actual energy savings of 21,411 megawatt hours were achieved through helping commercial and residential customers install energy efficient equipment and technologies. This represents an estimated 21,411 tons of carbon reduction. The energy savings also represent 1.8% of annual retail energy sales. Savings of 5.9 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 surpassed the goal of 5.0 million gallons, and was an increase of 1.7 million gallons over 2017.

See accompanying *Independent Auditors' Report*.

# FINANCIAL ANALYSIS – ELECTRIC UTILITY

## Condensed Financial Information – Electric Utility

December 31, 2018 and 2017

(In millions)

### Statements of Revenues, Expenses, & Changes in Net Position

	2018	2017	Change 2018 vs. 2017
Operating Revenues	\$169.3	\$160.7	\$8.6
Operating Expenses	142.1	134.4	7.7
<i>Operating Income</i>	27.2	26.3	0.9
Other Income & Expense	0.4	0.2	0.2
Interest Charges	(5.8)	(4.9)	(0.9)
Nonoperating Income (Expense)	(5.4)	(4.7)	(0.7)
<i>Income Before Transfer and Capital Contributions</i>	21.8	21.6	0.2
Transfers Out	(8.7)	(8.7)	-
Capital Contributions	2.1	3.0	(0.9)
<i>Change in Net Position</i>	15.2	15.9	(0.7)
Net Position - Beginning of Year	150.6	134.7	15.9
<b>Net Position - End of Year</b>	<b>\$165.8</b>	<b>\$150.6</b>	<b>\$15.2</b>

### Statements of Net Position

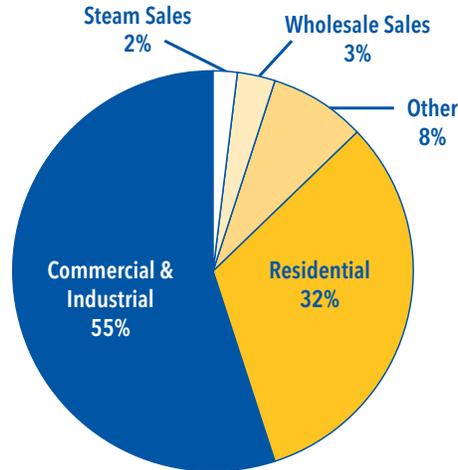
	2018	2017	Change 2018 vs. 2017
Cash and Investments – Unrestricted	\$78.8	\$56.8	\$22.0
Cash and Investments – Restricted	1.2	1.2	-
Other Current Assets	27.2	25.6	1.6
Capital Assets, Net	271.7	261.5	10.2
Other Noncurrent Assets	25.4	48.6	(23.2)
<i>Total Assets</i>	404.3	393.7	10.6
Deferred Outflows of Resources	5.4	8.0	(2.6)
<b>Total Assets and Deferred Outflows of Resources</b>	<b>\$409.7</b>	<b>\$401.7</b>	<b>\$8.0</b>
Current Liabilities	\$25.1	\$24.9	\$0.2
Long-Term Debt	192.1	200.0	(7.9)
Other Noncurrent Liabilities	20.6	20.4	0.2
<i>Total Liabilities</i>	237.8	245.3	(7.5)
Deferred Inflows of Resources	6.1	5.8	0.3
Investment in Capital Assets	88.0	93.3	(5.3)
Restricted – Debt Service	0.5	0.4	0.1
Unrestricted	77.3	56.9	20.4
<i>Net Position</i>	165.8	150.6	15.2
<b>Total Liabilities, Deferred Inflows of Resources and Net Position</b>	<b>\$409.7</b>	<b>\$401.7</b>	<b>\$8.0</b>

See accompanying *Independent Auditors' Report*.

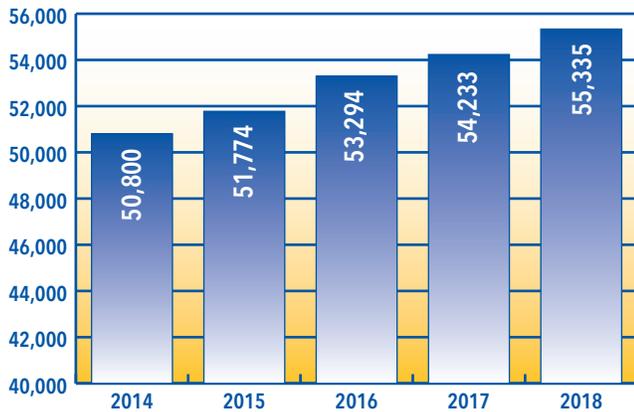
## OPERATING REVENUES

Operating revenues increased \$8.6 million (5.4%) in 2018. Retail revenues were up \$5.1 million (3.5%) due to a 1.5% rate increase effective January 1, 2018, as well as an increase in kilowatt-hour sales. Wholesale revenues more than doubled in 2018, increasing \$2.9 million due to the increased activity from Westside Energy Station, while other operating revenues increased \$0.6 million due to an increase in transmission revenue.

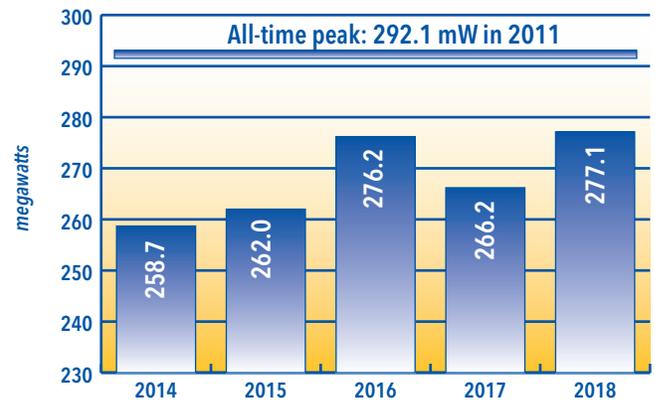
### Electric Operating Revenues



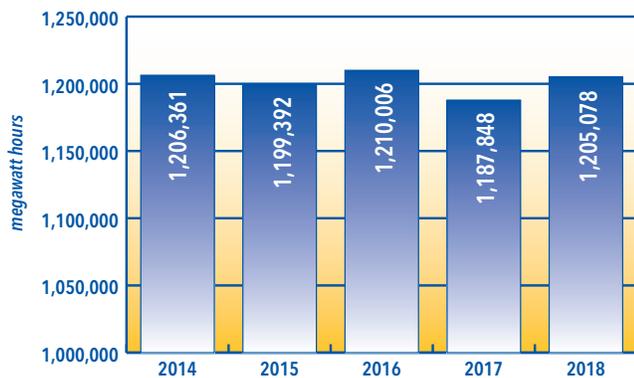
### Number of Electric Customers



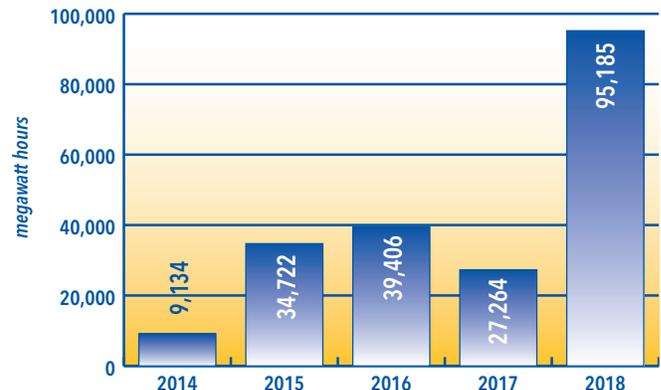
### Electric System Peaks



### Electric Retail Sales



### Electric Wholesale Sales

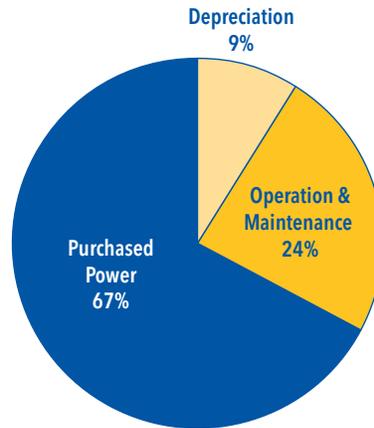


See accompanying *Independent Auditors' Report*.

## OPERATING EXPENSES

Operating expenses increased \$7.7 million (5.7%) in 2018, due to an increase in depreciation of \$2.0 million from the addition of the Westside Energy Station, as well as an increase in purchased power of \$1.9 million and generation fuel of \$2.1 million. Salaries and benefits also increased by \$1.0 million. The primary driver of operating expenses for the Electric Utility continues to be purchases of power from SPPA and the MISO market, which comprised 67% 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 \$8.7 million and \$8.4 million in 2018 and 2017 respectively. The increase in the in lieu of tax amount was due to an increase in kilowatt-hour sales combined with an increase in the in lieu of tax rate.

An additional transfer out of \$0.3 million in 2017 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 \$0.9 million in 2018. The previous year included amounts contributed from a large project that was completed in 2017.

## CHANGE IN NET POSITION

The increase in net position for 2018 was \$15.2 million, a decrease of \$0.7 million from 2017. Several factors contributed to this decrease. Retail revenues increased \$5.1 million over 2017, offset by a \$1.9 million increase in purchased power for a net improvement of \$3.2 million. Wholesale revenues increased \$2.9 million over 2017, offset by an increase in generation fuel of \$2.1 million for a net improvement of \$0.8 million. Transmission revenue also increased by \$0.7 million. These were offset by an increase in other operating expenses of \$3.6 million, along with an increase in bond interest expense of \$0.9 million, and a decrease in capital contributions of \$0.9 million.

### Electric – Change in Net Position

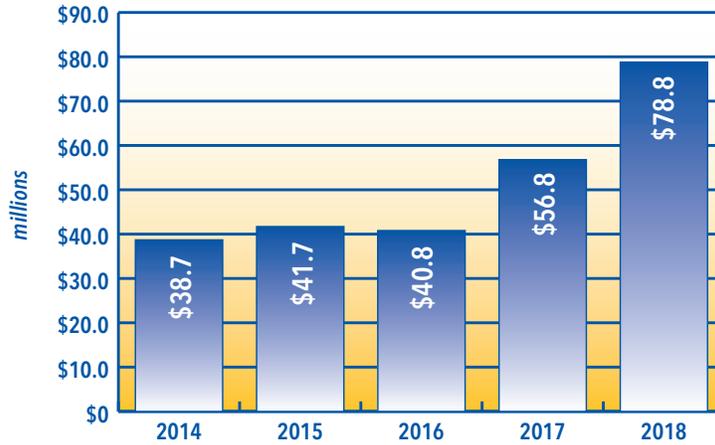


See accompanying *Independent Auditors’ Report*.

## CASH, INVESTMENTS AND OTHER ASSETS

The ending current unrestricted cash and investments balance for 2018 was \$78.8 million, \$22.0 million higher than 2017. Approximately \$11.2 million of the increase came from the reimbursement of prior capital expenditures out of proceeds from the 2017A bond issue. These bond funds will be used to complete the service center expansion and partially fund a new substation in the southeast part of Rochester. The ending current restricted cash and investments balance stayed steady in 2018 at \$1.2 million. This amount represents funds restricted for debt service payments. Other current assets for 2018 were \$27.2 million, \$1.6 million higher than 2017. This increase was due primarily to increases in accounts receivable, accrued utility revenues, and materials inventory. Other noncurrent assets for 2018 were \$25.4 million, \$23.2 million lower than 2017. This was due to the drawdown of the balance of bond proceeds remaining at the end of 2017.

### Electric – Unrestricted Cash & Investments



## LIABILITIES

Current liabilities and noncurrent liabilities remained steady in 2018.

## 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 2018, net position invested in capital assets decreased \$5.3 million compared to 2017.

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

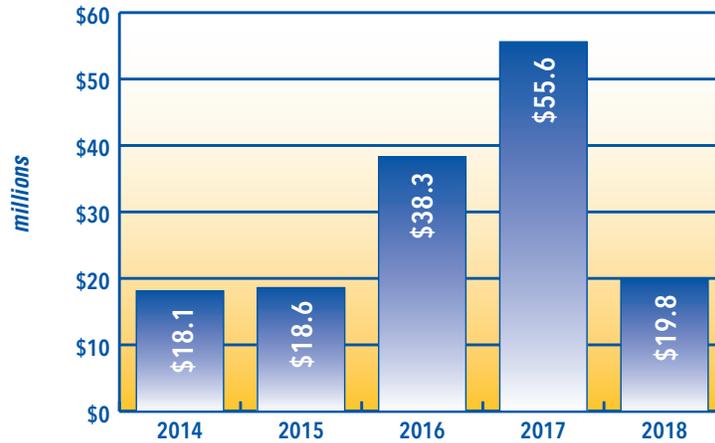
Unrestricted net position is not subject to any constraints by debt covenants or other legal requirements. In 2018, unrestricted net position increased \$20.4 million due to the results of operations.

See accompanying *Independent Auditors' Report*.

## CAPITAL ASSETS

At December 31, 2018, the Electric Utility had \$271.7 million invested in a broad range of utility capital assets, including a 46 megawatt reciprocating engine generation plant, two gas turbines, a hydroelectric 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 \$21.8 million in 2018, reflecting investments in generation plant, general facilities and the distribution and transmission systems. The increase in capital assets was offset by an \$11.6 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 \$35.8 million in 2018, due in large part to the completion of the Westside Energy Station in 2017.

### Electric – Capital Expenditures



## LONG-TERM DEBT

At the end of 2018, the Utility had \$176.9 million in revenue bonds outstanding. No new debt was issued, and \$5.5 million was retired in 2018.

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, 2018 and 2017

(In millions)

### Statements of Revenues, Expenses, & Changes in Net Position

	2018	2017	Change 2018 vs. 2017
Operating Revenues	\$10.8	\$10.2	\$0.6
Operating Expenses	9.9	9.5	0.4
<i>Operating Income</i>	0.9	0.7	0.2
Other Income & Expense	0.1	-	0.1
Nonoperating Income (Expense)	0.1	-	0.1
<i>Income Before Transfers and Capital Contributions</i>	1.0	0.7	0.3
Transfers Out (In Lieu Of Tax Payments)	(0.4)	(0.4)	-
Capital Contributions	1.7	2.8	(1.1)
<i>Change in Net Position</i>	2.3	3.1	(0.8)
Net Position - Beginning of Year	102.7	99.6	3.1
<b>Net Position - End of Year</b>	<b>\$105.0</b>	<b>\$102.7</b>	<b>\$2.3</b>

### Statements of Net Position

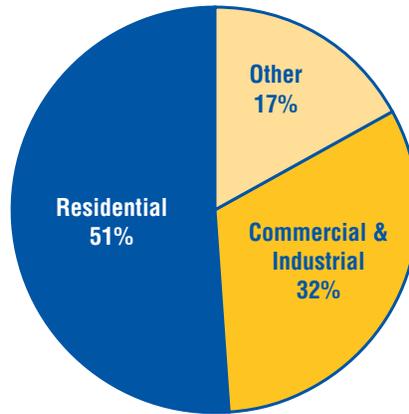
	2018	2017	Change 2018 vs. 2017
Cash and Investments	\$9.3	\$7.1	\$2.2
Other Current Assets	1.1	0.9	0.2
Capital Assets, Net	98.9	97.5	1.4
<i>Total Assets</i>	109.3	105.5	3.8
Deferred Outflows of Resources	0.5	0.8	(0.3)
<b>Total Assets and Deferred Outflows of Resources</b>	<b>\$109.8</b>	<b>\$106.3</b>	<b>\$3.5</b>
Current Liabilities	\$2.3	\$0.8	\$1.5
Noncurrent Liabilities	1.7	1.9	(0.2)
<i>Total Liabilities</i>	4.0	2.7	1.3
Deferred Inflows of Resources	0.8	0.9	(0.1)
Investment in Capital Assets	98.8	97.5	1.3
Unrestricted	6.2	5.2	1.0
<i>Net Position</i>	105.0	102.7	2.3
<b>Total Liabilities, Deferred Inflows of Resources and Net Position</b>	<b>\$109.8</b>	<b>\$106.3</b>	<b>\$3.5</b>

See accompanying *Independent Auditors' Report*.

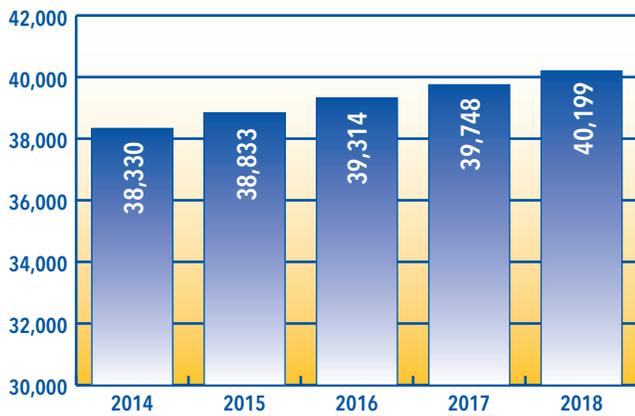
## OPERATING REVENUES

Operating revenues increased by \$0.6 million (5.9%) in 2018. Retail revenues were up \$0.5 million (5.3%), due primarily to a 6.0% rate increase effective January 1, 2018, offset by a decrease in sales volume.

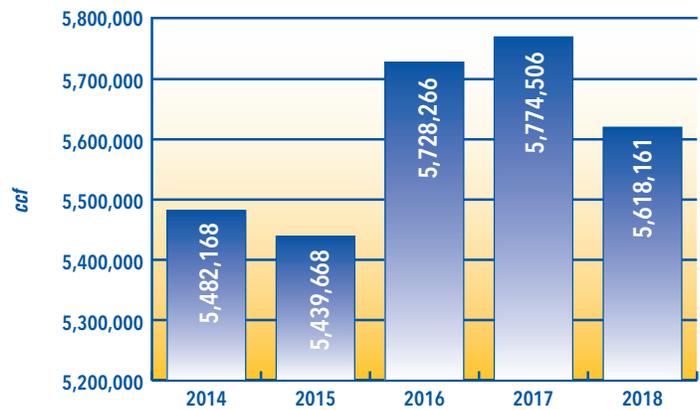
### Water Operating Revenues



### Number of Water Customers



### Water Retail Sales

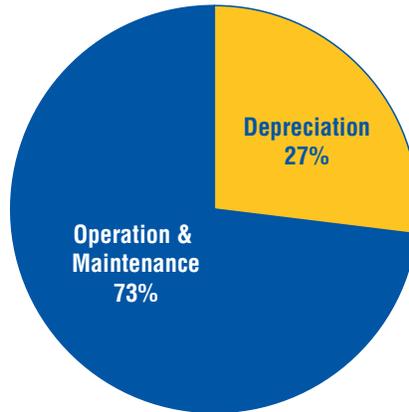


See accompanying *Independent Auditors' Report*.

## OPERATING EXPENSES

Operating expenses increased by \$0.4 million (4.2%) in 2018 due to increases in 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 2018, \$368,000 was transferred to the City. This was a decrease of \$2,000 from 2017 due to a decrease in the ccf sales volume, offset by an increase in the in lieu of tax rate.

## CAPITAL CONTRIBUTIONS

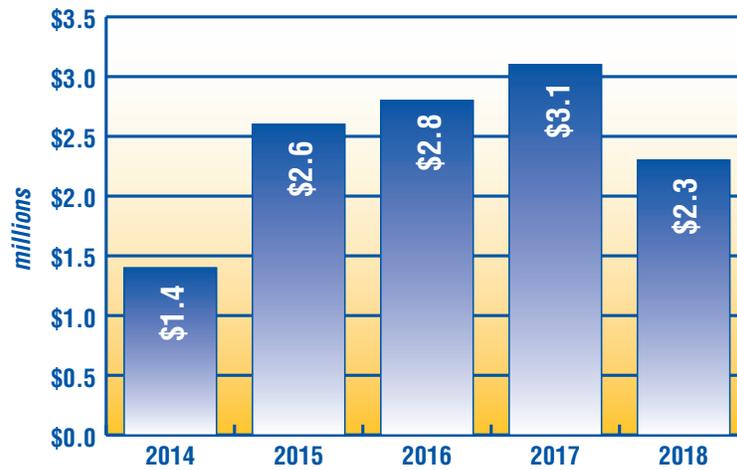
Capital contributions decreased \$1.1 million in 2018. These are assets, primarily water mains and fire hydrants, which are contributed to the Water Utility from both the City and developers and are valued using a costing database that estimates their approximate construction costs. Beginning in 2013, 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 2018.

See accompanying *Independent Auditors' Report*.

## CHANGE IN NET POSITION

The increase in net position for 2018 was \$2.3 million, \$0.8 million lower than in 2017. This is due to a net increase in operating income in 2018, offset by the decrease in capital contributions of \$1.1 million.

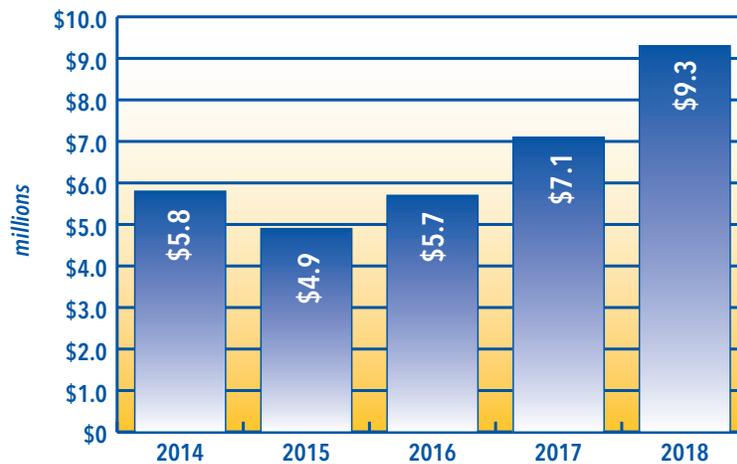
### Water – Change in Net Position



## CASH, INVESTMENTS AND OTHER ASSETS

The ending unrestricted cash and investments balance for 2018 was \$9.3 million, \$2.2 million higher than 2017.

### Water – Unrestricted Cash & Investments



See accompanying *Independent Auditors' Report*.

## LIABILITIES

Current liabilities increased \$1.5 million in 2018. The majority of this was due to an increase in the amount owed to the City at the end of 2018 for water main replacements in conjunction with City street projects. The remainder was due to an increase in accounts payable for subdivision work and sealing old wells.

Noncurrent liabilities decreased \$0.2 million in 2018 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

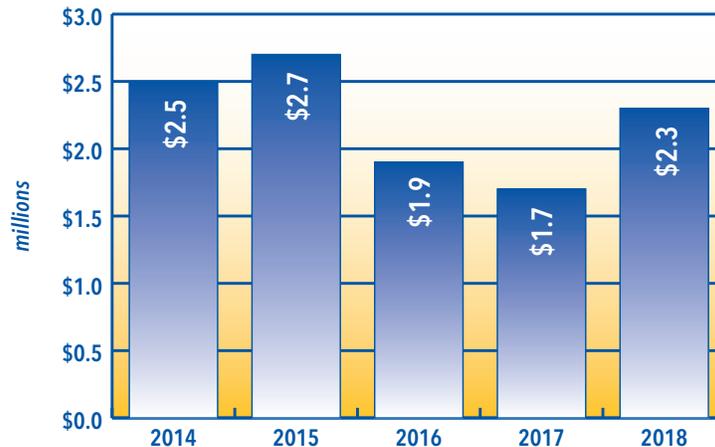
Net position invested in capital assets increased \$1.3 million. This increase reflects additions to capital assets funded through rate-based revenues and fees from customers as well as contributed assets.

Unrestricted net position is not subject to any constraints established by debt covenants or other legal requirements. In 2018, unrestricted net position increased \$1.0 million due to the results of operations.

## CAPITAL ASSETS

At December 31, 2018, the Water Utility had \$98.9 million invested in a broad range of utility capital assets, including 20 water storage facilities, 31 wells, water mains, pump station facilities, buildings, and equipment. Capital assets increased \$4.0 million in 2018, 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 \$2.6 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 \$0.6 million in 2018. Some of the major expenditure components in 2018 were Destination Medical Center (DMC) projects, water main replacements in conjunction with City street projects, metering, and the purchase of a hydro-vac unit.

## 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 2017, the Utility Board approved a 1.5% rate increase for 2018 for the Electric Utility and a 6.0% rate increase for the Water Utility. The rate increases maintain the financial health of both Utilities, fund capital replacements and the continued growth of the City, while contributing to reserves for future replacement of aging infrastructure. 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>
2019	2.0%*	1.9%	6.0%
2018	2.4%*	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%
<b>Annualized Average</b>	1.6%	2.5%	5.5%

\*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, future supply costs, regulatory changes, and others. Growth of the city directly affects several of these factors.

The housing market had a strong year again in 2018, with 348 building permits totaling \$98.4 million issued for single-family homes as compared to 437 permits totaling \$119.3 million in 2017. Commercial building permits for 2018 saw 36 permits totaling \$35.0 million as compared to 71 permits totaling \$114.5 million in 2017. The 2017 amounts included permits for two hotels and a parking garage, which drove the dollar value up significantly.

According to the US Department of Labor Bureau of Labor Statistics, the December 2018 unemployment rate of 2.8% for the area remains below the state and national rates of 3.2% and 3.9%, respectively. The employment data shows that, on average, there were slightly more people working in the Rochester area than the previous year.

The 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

See accompanying *Independent Auditors' Report*.

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. In 2017, an important milestone was reached when private investments reached the \$200 million mark, triggering the release of over \$500 million in State funding for infrastructure investment. 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. Several projects connected with Discovery Square and Heart of the City are either in process or have recently been approved by the DMC Corporation Board. These projects include:

- One Discovery Square – 90,000 square feet of lab and office space catering to the life science economy, expected to open in April 2019.
- 21 1st St SW development – a redevelopment of the Wells Fargo Center in the Heart of the City subdistrict.
- Holiday Inn Downtown development – a redevelopment of the existing Holiday Inn Downtown property and converting it to a Hotel Indigo
- Hyatt House development – hotel development of an under-utilized street corner and gateway into downtown Rochester and the Mayo Clinic medical campus.

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 has approved a 1.9% general rate increase in 2019 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](http://www.rpu.org).

See accompanying *Independent Auditors' Report*.

# Electric Utility

## Statement of Net Position

As of December 31, 2018

	2018
<b>ASSETS:</b>	
<b>Current Assets:</b>	
Cash and Cash Equivalents	\$11,657,118
Investments	67,163,063
Accounts Receivable (Net) and Accrued Utility Revenues	20,740,671
Inventories	5,407,106
Other Current Assets	1,041,164
Restricted Assets:	
Cash and Cash Equivalents	1,174,279
Total Current Assets	107,183,401
<b>Noncurrent Assets:</b>	
Restricted Assets:	
Investments	12,955,835
Funds-Held in Trust	121
Capital Assets:	
Construction Work in Progress	19,277,379
Land and Land Rights	9,542,782
Depreciable Assets, Net	242,896,473
Net Capital Assets	271,716,634
Other Assets	12,487,247
Total Noncurrent Assets	297,159,837
Total Assets	404,343,238
<b>DEFERRED OUTFLOWS OF RESOURCES</b>	
Deferred Bond Refunding	1,140,708
Pension Deferred Outflows of Resources	4,213,417
Total Deferred Outflows of Resources	5,354,125
Total Assets and Deferred Outflows of Resources	\$409,697,363
<b>LIABILITIES:</b>	
<b>Current Liabilities:</b>	
Accounts Payable	\$12,334,311
Due to the Municipality	2,812,158
Accrued Compensated Absences	1,696,715
Accrued Compensation	480,176
Customer Deposits	1,397,860
Current Liabilities Payable from Restricted Assets	
Interest Payable	697,196
Current Maturities of Long-Term Debt	5,725,000
Total Current Liabilities	25,143,416
<b>Noncurrent Liabilities:</b>	
Accrued Compensated Absences	1,300,053
Pre-1968 Pensions Liability	6,000
Net Pension Liability	12,826,293
Unearned Revenues	6,435,039
Long-Term Debt	192,075,867
Total Noncurrent Liabilities	212,643,252
Total Liabilities	237,786,668
<b>DEFERRED INFLOWS OF RESOURCES</b>	
Deferred Revenue	410,435
Pension Deferred Inflows of Resources	5,202,088
Solar Choice Deferred Inflows of Resources	508,842
Total Deferred Inflows of Resources	6,121,365
<b>NET POSITION:</b>	
Net Investment in Capital Assets	88,012,310
Restricted	
Debt Service	477,083
Funds-Held in Trust	121
Unrestricted	77,299,816
Total Net Position	165,789,330
Total Liabilities, Deferred Inflows of Resources and Net Position	\$409,697,363

See accompanying *Notes to Financial Statements*.

# Electric Utility

## Statement of Revenues, Expenses, and Changes in Net Position

For the Year Ended December 31, 2018

	2018
<b>Operating Revenues:</b>	
Retail	\$151,913,861
Wholesale	4,735,780
Other	12,645,592
Total Operating Revenues	<u>169,295,233</u>
<b>Operating Expenses:</b>	
Purchased Power	94,983,904
Operations and Maintenance	34,100,278
Depreciation	12,538,019
Amortization of Regulatory Assets	430,553
Total Operating Expenses	<u>142,052,754</u>
<b>Operating Income</b>	<u>27,242,479</u>
<b>Nonoperating Income (Expenses):</b>	
Investment Income	1,372,276
Interest Expense	(5,851,480)
Amortization of Regulatory Assets	(87,243)
Miscellaneous, Net	(864,755)
Total Nonoperating (Expenses)	<u>(5,431,202)</u>
<b>Income Before Transfers and Capital Contributions</b>	<u>21,811,277</u>
Transfers Out	(8,724,766)
Capital Contributions	2,060,389
<b>Change in Net Position</b>	<u>15,146,900</u>
Net Position, Beginning of Year	<u>150,642,430</u>
Net Position, End of Year	<u><u>\$165,789,330</u></u>

See accompanying *Notes to Financial Statements*.

# Electric Utility

## Statement of Cash Flows

For the Year Ended December 31, 2018

	2018
<b>Cash Flows From Operating Activities:</b>	
Cash Received from Customers	\$168,089,742
Cash Paid to Suppliers	(117,912,829)
Cash Paid to Employees	(16,488,768)
Internal Activity - Payments From Other Funds	6,945,404
Service Territory Acquisition	(344,577)
Net Cash Provided By Operating Activities	<u>40,288,972</u>
<b>Cash Flows From Noncapital Financing Activities:</b>	
Operating Transfers to Other Funds	<u>(8,720,009)</u>
<b>Cash Flows From Capital and Related Financing Activities:</b>	
Additions to Utility Plant and Other Assets	(22,005,888)
Capital Contributions Received	2,060,389
Principal Payments on Bonds	(5,460,000)
Interest Payments on Bonds	(8,632,000)
Net Cash Used In Capital and Related Financing Activities	<u>(34,037,499)</u>
<b>Cash Flows From Investing Activities:</b>	
Interest Received	1,372,276
Investment Purchases	(18,233,414)
Net Cash Used In Investing Activities	<u>(16,861,138)</u>
Net Decrease in Cash and Cash Equivalents	<u>(19,329,674)</u>
<b>Cash and Cash Equivalents, Beginning of Year</b>	<u>32,161,071</u>
<b>Cash and Cash Equivalents, End of Year</b>	<u>12,831,397</u>
<b>Classified As:</b>	
Current Nonrestricted Assets	11,657,118
Restricted Assets	1,174,279
<b>Cash and Cash Equivalents, End of Year</b>	<u>\$12,831,397</u>
	<u>2018</u>
<b>Reconciliation of Operating Income to Net Cash Provided by Operating Activities:</b>	
Operating Income	\$27,242,479
Adjustments to Reconcile Operating Income to	
Net Cash Provided by (Used in) Operating Activities:	
Depreciation and Amortization	12,968,572
Bad Debts	422,232
Service Territory Payments	(344,577)
Miscellaneous Expense	(864,755)
(Increase) Decrease In:	
Accounts Receivable and Accrued Utility Revenues	(1,415,618)
Inventories	(538,344)
Other Current Assets	(21,731)
Increase (Decrease) In:	
Accrued Liabilities and Accounts Payable	(2,833,250)
Customer Deposits	527,955
Deferred Lease Revenues	(36,420)
Unearned Revenues	2,332,339
Pension Deferred Outflow/Inflow	2,341,248
Solar Choice Deferred Inflow	508,842
Net Cash Provided by Operating Activities	<u>\$40,288,972</u>
<b>Noncash Financing and Investing Activities:</b>	
Allowance for Funds Used During Construction	\$717,398
Amortization of Bond Premiums, Discounts, and Refunding	(\$2,052,535)
Amortization of Bond Issue Costs	\$87,243
Unrealized Loss on Investments	\$56,300

See accompanying *Notes to Financial Statements*.

# Water Utility

## Statement of Net Position

As of December 31, 2018

	2018
<b>ASSETS:</b>	
<b>Current Assets:</b>	
Cash and Cash Equivalents	\$1,380,572
Investments	7,954,236
Accounts Receivable (Net) and Accrued Utility Revenues	827,058
Inventories	198,788
Other Current Assets	71,019
Total Current Assets	10,431,673
<b>Noncurrent Assets:</b>	
Capital Assets:	
Construction Work in Progress	3,682,214
Land and Land Rights	677,486
Depreciable Assets, Net	94,483,406
Net Capital Assets	98,843,106
Total Noncurrent Assets	98,843,106
Total Assets	109,274,779
<b>DEFERRED OUTFLOWS OF RESOURCES</b>	
Pension Deferred Outflows of Resources	495,834
Total Assets and Deferred Outflows of Resources	\$109,770,613
<b>LIABILITIES:</b>	
<b>Current Liabilities:</b>	
Accounts Payable	\$633,680
Due to the Municipality	1,154,196
Accrued Compensated Absences	286,753
Accrued Compensation	60,132
Customer Deposits	129,534
Total Current Liabilities	2,264,295
<b>Noncurrent Liabilities:</b>	
Accrued Compensated Absences	205,628
Net Pension Liability	1,494,728
Total Noncurrent Liabilities	1,700,356
Total Liabilities	3,964,651
<b>DEFERRED INFLOWS OF RESOURCES</b>	
Deferred Revenue	200,640
Pension Deferred Inflows of Resources	606,994
Total Deferred Inflows of Resources	807,634
<b>NET POSITION:</b>	
Net Investment in Capital Assets	98,843,106
Unrestricted	6,155,222
Total Net Position	104,998,328
Total Liabilities, Deferred Inflows of Resources and Net Position	\$109,770,613

See accompanying *Notes to Financial Statements*.

# Water Utility

## Statement of Revenues, Expenses, and Changes in Net Position

For the Year Ended December 31, 2018

	2018
<b>Operating Revenues:</b>	
Retail	\$9,600,577
Other	1,216,721
Total Operating Revenues	<u>10,817,298</u>
<b>Operating Expenses:</b>	
Operations and Maintenance	7,270,108
Depreciation	2,673,736
Total Operating Expenses	<u>9,943,844</u>
<b>Operating Income</b>	<u>873,454</u>
<b>Nonoperating Income (Expenses):</b>	
Investment Income	145,699
Interest Expense	(233)
Miscellaneous, Net	(30,977)
Total Nonoperating Income	<u>114,489</u>
<b>Income Before Transfers and Capital Contributions</b>	<u>987,943</u>
Transfers Out	(367,989)
Capital Contributions	1,657,094
<b>Change in Net Position</b>	<u>2,277,048</u>
Net Position, Beginning of Year	<u>102,721,280</u>
Net Position, End of Year	<u><u>\$104,998,328</u></u>

See accompanying *Notes to Financial Statements*.

# Water Utility

## Statement of Cash Flows

For the Year Ended December 31, 2018

	2018
<b>Cash Flows From Operating Activities:</b>	
Cash Received from Customers	\$10,657,262
Cash Paid to Suppliers	(5,370,734)
Cash Paid to Employees	(1,866,687)
Internal Activity - Payments From Other Funds	189,012
Net Cash Provided By Operating Activities	<u>3,608,853</u>
<b>Cash Flows From Noncapital Financing Activities:</b>	
Operating Transfers to Other Funds	(369,452)
<b>Cash Flows From Capital and Related Financing Activities:</b>	
Additions to Utility Plant and Other Assets	(1,172,842)
Net Cash Used In Capital and Related Financing Activities	<u>(1,172,842)</u>
<b>Cash Flows From Investing Activities:</b>	
Interest Received	145,467
Investment Purchases	(2,227,068)
Investment Redemptions	404,060
Net Cash Used In Investing Activities	<u>(1,677,541)</u>
Net Increase in Cash and Cash Equivalents	389,018
<b>Cash and Cash Equivalents, Beginning of Year</b>	<u>991,554</u>
<b>Cash and Cash Equivalents, End of Year</b>	<u><u>\$1,380,572</u></u>

	2018
<b>Reconciliation of Operating Income to Net Cash Provided by Operating Activities:</b>	
Operating Income	\$873,454
Adjustments to Reconcile Operating Income to	
Net Cash Provided by (Used in) Operating Activities:	
Depreciation	2,673,736
Bad Debts	28,029
Miscellaneous Expense	(30,977)
(Increase) Decrease In:	
Accounts Receivable and Accrued Utility Revenues	(190,450)
Inventories	(15,133)
Prepaid and Other Current Assets	(8,658)
Increase (Decrease) In:	
Accrued Liabilities and Accounts Payable	(20,285)
Customer Deposits	48,734
Deferred Revenue	(20,324)
Pension Deferred Outflow/Inflow	270,727
Net Cash Provided by Operating Activities	<u><u>\$3,608,853</u></u>
<b>Noncash Financing and Investing Activities:</b>	
Additions to Utility Plant and Other Assets Contributed By:	
City's Governmental Funds	\$65,475
Developers	\$1,591,619

See accompanying *Notes to Financial Statements*.

# NOTES TO FINANCIAL STATEMENTS

As of and for the Year Ended December 31, 2018

## 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 2018 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 \$280,000 for the Electric Utility and \$20,000 for the Water Utility for December 31, 2018.

Revenues are recognized on the accrual basis of accounting and include estimated amounts for service rendered but not billed. Accrued revenue amounts are \$6,593,483 for the Electric Utility and \$183,438 for the Water Utility for the year ended December 31, 2018.

### 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:

<b>Electric Plant</b>	<b>Years</b>
Generation	10-60
Transmission	20-45
Distribution	10-50
General	5-50

<b>Water Plant</b>	<b>Years</b>
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 2018 follows:

	<u>Balance 1/1/18</u>	<u>Increases</u>	<u>Decreases</u>	<u>Balance 12/31/18</u>
Bond issue costs	\$2,319,943	\$ -	\$ -	\$2,319,943
Less: Amortization of bond issue costs	1,203,846	87,243	-	1,291,089
Nonoperating Other Assets	1,116,097			1,028,854
Regulatory asset-Service territory payments	16,714,189	428,320	-	17,142,509
Less: Amortization of Regulatory asset	5,253,563	430,553	-	5,684,116
Operating Other Assets	11,460,626			11,458,393
Net Other Assets	<u>\$12,576,723</u>			<u>\$12,487,247</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, 2018 is \$1,140,708.

A deferred outflow of resources represents a consumption of net position that applies to a future period and will not be recognized as an outflow of resources (expense) until that future time.

**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. 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. During 2018,

\$228,000 of the potential refund became ineligible for refund as the load requirement was not met and, as of December 31, 2018, \$2,052,000 of the potential refund remained recorded as an Unearned Revenue. The amount of Unearned Revenue will be reduced each year through the remainder of 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, 2018, RPU has received \$4,330,456 in ATRR payments. The payments are subject to refund if the ultimate outcome is 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, 2018, customers had paid the Electric Utility \$52,583 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.

### **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.

### **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, 2018 was \$410,435.

Beginning in January, 2018, the Electric Utility, working through its primary power supplier SMMPA, began a new program offering called SolarChoice whereby customers can subscribe to one or more solar panels from a utility-scale solar installation contracted to SMMPA. Each month customers receive a bill credit for the amount of energy generated by their subscribed panels. The subscription cost of \$650 per solar panel was initially recorded as a deferred inflow and is being recognized into revenue ratably over the twelve-year term of the subscription, 2018 through 2029. As of December 31, 2018 \$508,842 remained as deferred.

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, 2018 was \$200,640.

A deferred inflow of resources represents an acquisition of net position that applies to a future period and therefore will not be recognized as an inflow of resources (revenue) until that future time.

## 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, 2018.

### 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 \$22,508,081 (\$18,185,913 Retail and \$4,322,168 Other) in 2018. 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. 83, *Certain Asset Retirement Obligations*, Statement No. 84, *Fiduciary Activities*, Statement No. 87, *Leases*, Statement No. 88, *Certain Disclosures Related to Debt, including Direct Borrowings and Direct Placements*, Statement No. 89, *Accounting for Interest Cost Incurred before the End of a Construction Period*, and Statement No. 90, *Majority Equity Interests—an amendment of GASB Statements No. 14 and No. 61*. 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 2018 Comprehensive Annual Financial Report.

## NOTE 3: Due to the Municipality

The following is a schedule of balances as of December 31, 2018:

<u>Due To</u>	<u>Due From</u>	<u>Principal Purpose</u>	<u>2018 Amount</u>
Municipality	Electric	General operating	\$165,232
Municipality	Electric	Payments in lieu of tax	696,993
Municipality	Electric	Sewer and Storm water revenue	3,072,525
<b>Total Electric Due To Municipality</b>			<b>3,934,750</b>
Electric	Municipality	Sewer and Storm water billing fees	138,098
Electric	Municipality	Utility bills	453,163
Electric	Municipality	Utility bill collections	681
Electric	Municipality	Fiber Willow Creek-Bamber Valley	143,619
Electric	Municipality	General operating	27,065
Electric	Municipality	Interest on investments	359,966
<b>Total Electric Due From Municipality</b>			<b>1,122,592</b>
<b>Electric Net Due to Municipality</b>			<b>\$2,812,158</b>
Municipality	Water	General operating	\$40,175
Municipality	Water	Watermain replacement	1,102,933
Municipality	Water	Payments in lieu of tax	23,685
<b>Total Water Due To Municipality</b>			<b>1,166,793</b>
Water	Municipality	Utility bills	8,839
Water	Municipality	General operating	3,758
<b>Total Water Due From Municipality</b>			<b>12,597</b>
<b>Water Net Due to Municipality</b>			<b>\$1,154,196</b>

The following is a schedule of transfer balances for the year ending December 31, 2018:

	<u>From</u>	<u>To</u>	<u>Principal Purpose</u>	<u>2018 Amount</u>
<b><u>ELECTRIC:</u></b>	Electric	Municipality	Tax Equivalents	\$8,724,766
<b><u>WATER:</u></b>	Water	Municipality	Tax Equivalents	\$367,989

## 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:

	<u>2018</u>
<b>Current Assets</b>	
<b>Debt Service Account</b>	\$1,174,279
Used to segregate resources accumulated for debt service payments over the next twelve months.	
<b>Noncurrent Assets</b>	
<b>Reserve Account</b>	\$12,955,835
Proceeds deposited to be used to pay principal and interest payments on long-term debt.	

## NOTE 5: Changes in Capital Assets

### ELECTRIC

A summary of changes in electric capital assets for 2018 follows:

	<b>Balance 1/1/18</b>	<b>Increases</b>	<b>Decreases</b>	<b>Balance 12/31/18</b>
Capital assets, not being depreciated:				
Construction in progress	\$76,274,809	\$12,939,570	\$69,937,000	\$19,277,379
Land and land rights	9,619,257	202,836	279,311	9,542,782
Total capital assets, not being depreciated	<u>85,894,066</u>	<u>13,142,406</u>	<u>70,216,311</u>	<u>28,820,161</u>
Capital assets, being depreciated:				
Buildings, structures and improvements	41,446,480	13,851,123	-	55,297,603
Installations, equipment and fixtures	342,484,203	66,866,089	1,757,017	407,593,275
Total capital assets, being depreciated	<u>383,930,683</u>	<u>80,717,212</u>	<u>1,757,017</u>	<u>462,890,878</u>
Less: Accumulated depreciation	<u>208,366,872</u>	<u>12,538,019</u>	<u>910,486</u>	<u>219,994,405</u>
Depreciable Assets, Net	<u>175,563,811</u>			<u>242,896,473</u>
Net Capital Assets	<u>\$261,457,877</u>			<u>\$271,716,634</u>

### WATER

A summary of changes in water capital assets for 2018 follows:

	<b>Balance 1/1/18</b>	<b>Increases</b>	<b>Decreases</b>	<b>Balance 12/31/18</b>
Capital assets, not being depreciated:				
Construction in progress	\$1,650,867	\$3,292,933	\$1,261,586	\$3,682,214
Land and land rights	677,486	-	-	677,486
Total capital assets, not being depreciated	<u>2,328,353</u>	<u>3,292,933</u>	<u>1,261,586</u>	<u>4,359,700</u>
Capital assets, being depreciated:				
Buildings, structures and improvements	19,163,683	25,488	-	19,189,171
Installations, equipment and fixtures	124,751,360	2,014,442	86,244	126,679,558
Total capital assets, being depreciated	<u>143,915,043</u>	<u>2,039,930</u>	<u>86,244</u>	<u>145,868,729</u>
Less: Accumulated depreciation	<u>48,766,855</u>	<u>2,673,736</u>	<u>55,268</u>	<u>51,385,323</u>
Depreciable Assets, Net	<u>95,148,188</u>			<u>94,483,406</u>
Net Capital Assets	<u>\$97,476,541</u>			<u>\$98,843,106</u>

In 2018, capital assets totaling \$65,475 were contributed to the Utility by other funds of the City of Rochester, and \$1,591,619 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 12/31/18
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	\$104,790,000
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	36,550,000
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	35,565,000

Revenue bond debt service requirements to maturity follows:

<u>Year Ending December 31</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
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	6,955,000	7,140,800	14,095,800
2024-2028	39,765,000	30,715,300	70,480,300
2029-2033	30,545,000	21,919,350	52,464,350
2034-2038	24,280,000	16,158,500	40,438,500
2039-2043	30,685,000	9,751,000	40,436,000
2044-2047	19,995,000	2,560,250	22,555,250
	<u>\$176,905,000</u>	<u>\$119,943,050</u>	<u>\$296,848,050</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 2018 was \$14,092,000, which consisted entirely of scheduled principal and interest payments. Total gross revenues as defined for the same period were \$170,667,509. Annual principal and interest payments are expected to require 6% of gross revenues on average.

**LONG-TERM OBLIGATIONS SUMMARY – ELECTRIC**

Long-term obligation activity for the year ended December 31, 2018 is as follows:

	<u>1/1/18 Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>12/31/18 Balance</u>	<u>Due Within One Year</u>
Long-term debt	\$182,365,000	\$ -	\$5,460,000	\$176,905,000	\$5,725,000
Bond discount/premium	23,133,796	5,774	2,243,703	20,895,867	-
Accrued Compensated Absences	2,909,000	282,527	194,759	2,996,768	1,696,715
Pre-1968 Pension Liability	6,000	-	-	6,000	-
Net Pension Liability	15,060,666	-	2,234,373	12,826,293	-
Unearned Revenue	4,102,700	2,346,739	14,400	6,435,039	-
Totals	<u>\$227,577,162</u>	<u>\$2,635,040</u>	<u>\$10,147,235</u>	<u>\$220,064,967</u>	<u>\$7,421,715</u>

**LONG-TERM OBLIGATIONS SUMMARY – WATER**

Long-term obligation activity for the year ended December 31, 2018 is as follows:

	<u>1/1/18 Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>12/31/18 Balance</u>	<u>Due Within One Year</u>
Accrued Compensated Absences	\$448,310	\$44,071	\$ -	\$492,381	\$286,753
Net Pension Liability	1,756,779	-	262,051	1,494,728	-
Totals	<u>\$2,205,089</u>	<u>\$44,071</u>	<u>\$262,051</u>	<u>\$1,987,109</u>	<u>\$286,753</u>

**INTEREST EXPENSE – ELECTRIC**

	<u>2018</u>
Bond interest expense	\$8,609,862
Bond premium, discount & refunding amortization	(2,052,535)
Interest expense	11,551
Allowance for funds used during construction	(717,398)
Totals	<u>\$5,851,480</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 Plan 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 the Coordinated Plan. Coordinated Plan members are covered by Social Security.

### **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. 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.

General Employees Plan 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. Members hired prior to July 1, 1989, receive the higher of Method 1 or Method 2 formulas. Only Method 2 is used for members hired after June 30, 1989. Under Method 1, the accrual rate for Coordinated members is 1.2% of average salary for each of the first 10 years of service and 1.7% of average salary for each additional year. Under Method 2, the accrual rate for Coordinated members is 1.7% of average salary for all years 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.

Benefit increases are provided to benefit recipients each January. Increases are related to the funding ratio of the plan. If the General Employees Plan is at least 90% funded for two consecutive years, benefit recipients are given a 2.5% increase. If the plan has not exceeded 90% funded, or have fallen below 80%, benefit recipients are given a 1% increase. A benefit recipient who has been receiving a benefit for at least 12 full months as of June 30, will receive a full increase. Members receiving benefits for at least one month but less than 12 full months as of June 30, will receive a pro rata increase.

**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 2018; the Utilities were required to contribute 7.5% for Coordinated Plan members. The Utilities’ contributions to the General Employees Fund for the year ended December 31, 2018, were \$1,189,801 and \$138,727 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, 2018, the Electric Utility reported a liability of \$12,826,293, and the Water Utility reported a liability of \$1,494,728 as each utility’s allocated share of the City of Rochester’s proportionate share of \$41,446,045 of the General Employees Fund’s net pension liability. The City of Rochester’s net pension liability reflected a reduction due to the State of Minnesota’s contribution of \$16 million to the fund in 2018. 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 \$1,359,493. The net pension liability was measured as of June 30, 2018 and the total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of that date. The City of Rochester’s proportion of the 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, 2017, through June 30, 2018, relative to the total employer contributions received from all of PERA’s participating employers. At June 30, 2018, the City’s proportionate share was 0.7471% which was a decrease of 0.0230% from its proportion measured as of June 30, 2017.

City of Rochester’s proportionate share of the net pension liability	\$41,446,045
State of Minnesota’s proportionate share of the net pension liability associated with the City of Rochester	1,359,493
Total	\$42,805,538

NOTE 8: Pension Plans (continued)...

For the year ended December 31, 2018, the Electric Utility and Water Utility recognized pension expense of \$1,250,265 and \$142,197 respectively as allocated shares of the City of Rochester's General Employees Plan's pension expense. In addition, the City recognized an additional \$317,031 as pension expense (and grant revenue) for its proportionate share of the State of Minnesota's contribution of \$16 million to the General Employees Fund.

At December 31, 2018, the Electric Utility reported its allocated share of the City of Rochester's General Employees Plan's deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

	<b><u>Deferred Outflows of Resources</u></b>	<b><u>Deferred Inflows of Resources</u></b>
Differences between expected and actual economic experience	\$346,098	\$356,702
Changes in actuarial assumptions	1,168,290	1,461,268
Difference between projected and actual investment earnings	1,570,591	2,988,717
Changes in proportion	534,782	395,401
Contributions paid to PERA subsequent to the measurement date	593,656	-
Total	\$4,213,417	\$5,202,088

\$593,656 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, 2019. Other amounts reported as deferred outflows and inflows of resources related to pensions will be recognized in pension expense as follows:

<b>Year ended December 31:</b>	<b>Pension Expense Amount</b>
2019	\$443,446
2020	(590,958)
2021	(1,167,109)
Thereafter	(267,706)

At December 31, 2018, the Water Utility reported its allocated share of the City of Rochester's General Employees Plan's deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

	<b><u>Deferred Outflows of Resources</u></b>	<b><u>Deferred Inflows of Resources</u></b>
Differences between expected and actual economic experience	\$40,370	\$41,952
Changes in actuarial assumptions	137,400	170,401
Difference between projected and actual investment earnings	185,234	348,505
Changes in proportion	62,381	46,136
Contributions paid to PERA subsequent to the measurement date	70,449	-
Total	\$495,834	\$606,994

\$70,449 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, 2019. 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
2019	\$53,920
2020	(68,251)
2021	(136,080)
Thereafter	(31,198)

### E. Actuarial Assumptions

The total pension liability in the June 30, 2018, 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 for all plans 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 after retirement for retirees are assumed to be 1.25% per year for the General Employees Plan.

The following changes in actuarial assumptions occurred in 2018:

- The mortality projection scale was changed from MP-2015 to MP-2017.
- The assumed benefit increase was changed from 1.0% per year through 2044 and 2.5% per year thereafter to 1.25% per year.

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	36%	5.10%
International Stocks	17%	5.30%
Bonds	20%	0.75%
Alternative Assets	25%	5.90%
Cash	2%	0.00%
Total	100%	

**F. Discount Rate**

The discount rate used to measure the total pension liability in 2018 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 General Employees Fund 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 one percentage point lower or one percentage point higher than the current discount rate:

	<b>1% Decrease in Discount Rate (6.5%)</b>	<b>Current Discount Rate (7.5%)</b>	<b>1% Increase in Discount Rate (8.5%)</b>
Electric Utility's allocated share of the General Employees Fund net pension liability:	\$20,844,369	\$12,826,293	\$6,207,601
Water Utility's allocated share of the General Employees Fund net pension liability:	\$2,429,125	\$1,494,728	\$723,411

**H. Pension Plan Fiduciary Net Position**

Detailed information about the 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](http://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, 2018 was \$31,495.

**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 2018 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 2018 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 rate-making 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 rate-making 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 and Westside Energy Station reciprocating engines.

### **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 14.61 mills (tenths of a cent) per kWh to 25.50 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 1,225,107,617 kilowatt hours totaling \$93,617,747 from SMMPA during the year ended December 31, 2018.

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, 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

### 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 originally 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, 2018, RPU had provided \$399,662 in funding leaving a committed balance of \$767,338. 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, 2018. At year end, the Utilities' significant commitments are as follows:

<u>Electric Projects</u>	<u>Spent-to-Date</u>	<u>Remaining Commitment</u>
Building Expansion	\$8,739,329	\$2,196,758
Cayenta Implementation	2,407,110	470,740
Directional Boring	1,189,205	510,795
Lake Zumbro Dredging	399,662	767,338
Customer Billing and Payments	148,848	3,330,089
Stock Materials	10,213	998,746
<u>Water Projects</u>	<u>Spent-to-Date</u>	<u>Remaining Commitment</u>
Water Main Analysis	123,914	73,686
Engineering & Consulting	54,653	112,348
Well Sealing	-	77,548

## **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 from transmission customers in the Midcontinent Independent System Operator, Inc. (MISO) region. During 2018 FERC issued an order affirming the Administrative Law Judge's 2017 ruling that RPU was entitled to recovery of its revenue requirement related to its investment in MISO Zone 16. However, FERC's order is subject to requests for rehearing and possible appeals to the United States Court of Appeals. The case will not be final until either the time for filing of a petition for review lapses with no such petition having been filed, or upon final order of the Court of Appeals. The related payments MISO has made and will make to RPU until the final determination is known remain subject to refund. As of December 31, 2018, RPU had \$4,330,456 recorded as an Unearned Revenue related to this matter. The matter does not involve a claim or assessment against RPU.

## **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 and December 2018, the Utility Board and the City Council respectively approved a 1.9% overall rate increase for the Electric Utility effective January 1, 2019.

In November and December 2018, the Utility Board and the City Council respectively approved a 6.0% overall rate increase for the Water Utility effective January 1, 2019.

On February 19, 2019, the RPU Board of Directors approved executing three contracts totaling \$1,705,541 between the RPU Electric Utility and Asplundh Tree Experts LLC, New Age Tree Service of MN, and Wright Tree Services, Inc. for power line clearance tree services. The work is to be completed in 2019.

In preparing these financial statements, Rochester Public Utilities has evaluated events and transactions for potential recognition or disclosure through March 29, 2019, the date the financial statements were available to be issued.

# REQUIRED SUPPLEMENTARY INFORMATION (unaudited)

As of and for the Year Ended December 31, 2018

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 Payroll (d)	Contributions as a Percentage of Covered 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%
December 31, 2018	\$1,189,801	\$1,189,801	\$ -	\$15,864,013	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 Payroll (d)	Contributions as a Percentage of Covered 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%
December 31, 2018	\$138,727	\$138,727	\$ -	\$1,849,693	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\*)**

<b>Fiscal Year Ending (for the Measurement Period)</b>	<b>City of Rochester's Proportion (Percentage) of Net Pension Liability (Asset)</b>	<b>RPU Electric Utility's Allocated Share (Amount) of the Net Pension Liability (Asset) (a)</b>	<b>RPU Electric Utility's Covered Payroll (b)</b>	<b>RPU Electric Utility's Allocated Share of the Net Pension Liability (Asset) as a Percentage of its Covered Payroll (a/b)</b>	<b>Plan Fiduciary Net Position as a Percentage of the Total Pension Liability</b>
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%
June 30, 2018	0.7471%	\$12,826,294	\$14,829,552	86.49%	79.53%

**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\*)**

<b>Fiscal Year Ending (for the Measurement Period)</b>	<b>City of Rochester's Proportion (Percentage) of Net Pension Liability (Asset)</b>	<b>RPU Water Utility's Allocated Share (Amount) of the Net Pension Liability (Asset) (a)</b>	<b>RPU Water Utility's Covered Payroll (b)</b>	<b>RPU Water Utility's Allocated Share of the Net Pension Liability (Asset) as a Percentage of its Covered Payroll (a/b)</b>	<b>Plan Fiduciary Net Position as a Percentage of the Total Pension Liability</b>
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%
June 30, 2018	0.7471%	\$1,494,729	\$1,696,245	88.12%	79.53%

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, 2018

## **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 occurred in 2018:**

Changes in Actuarial Assumptions:

- The mortality projection scale was changed from MP-2015 to MP-2017.
- The assumed benefit increase was changed from 1.0% per year through 2044 and 2.5% per year thereafter to 1.25% per year.

### **The following changes occurred in 2017:**

Changes in Plan Provisions:

- The State's special funding contribution increased from \$6 million to \$16 million.

Changes in Actuarial Assumptions:

- 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.

See accompanying *Independent Auditors' Report*.

**The following changes occurred in 2016:**

Changes in Actuarial Assumptions:

- The assumed post-retirement benefit increase rate was changed from 1% per year through 2035 and 2.5% per year thereafter to 1% per year for all years.
- The assumed investment return was changed from 7.9% to 7.5%. The single discount rate was changed from 7.9% to 7.5%.
- Other assumptions were changed pursuant to the experience study dated June 30, 2015. The assumed future salary increases, payroll growth, and inflation were decreased by 0.25% to 3.25% for payroll growth and 2.5% for inflation.

**The following changes occurred in 2015:**

Changes in Plan Provisions:

- On January 1, 2015 the Minneapolis Employees Retirement Fund was merged into the General Employees Fund, which increased the total pension liability by \$1.1 billion and increased the fiduciary plan net position by \$892 million. Upon consolidation, state and employer contributions were revised; the State's contribution of \$6 million, which meets the special funding situation definition, is due September 2015.

Changes in Actuarial Assumptions:

- The assumed post-retirement benefit increase rate was changed from 1% per year through 2030 and 2.5% per year thereafter to 1% per year through 2035 and 2.5% per year thereafter.

See accompanying *Independent Auditors' Report*.

# OPERATING AND FINANCIAL STATISTICS (unaudited)

## ELECTRIC

	<u>2018</u>	<u>2017</u>	<u>2016</u>	<u>2015</u>	<u>2014</u>	<u>2008</u> <i>(ten years ago)</i>
<b>RETAIL CUSTOMERS:</b>						
Residential	50,353	49,323	48,426	46,961	46,035	42,861
General Service	4,976	4,904	4,862	4,807	4,759	4,540
Industrial / Commercial	2	2	2	2	2	2
Other	4	4	4	4	4	4
Total Retail Customers	55,335	54,233	53,294	51,774	50,800	47,407
<b>RETAIL SALES: (mWh)</b>						
Residential	362,234	339,825	346,974	335,708	341,452	328,030
General Service	700,973	645,765	653,742	644,067	637,360	640,711
Industrial / Commercial	127,341	187,572	194,520	205,164	212,297	306,828
Other	14,530	14,686	14,770	14,453	15,252	15,534
Total Retail Sales (mWh)	1,205,078	1,187,848	1,210,006	1,199,392	1,206,361	1,291,103
<b>RETAIL REVENUE:</b>						
Residential	\$53,451,092	\$49,179,998	\$46,886,573	\$44,025,807	\$42,818,865	\$37,790,777
General Service	79,841,855	72,689,236	69,181,817	66,051,022	63,734,518	57,912,677
Industrial / Commercial	13,505,761	18,971,304	18,212,053	18,227,249	18,277,321	21,159,879
Other	5,115,153	5,938,292	7,730,497	5,256,387	5,617,573	4,544,124
Total Retail Revenue	\$151,913,861	\$146,778,830	\$142,010,940	\$133,560,465	\$130,448,277	\$121,407,457
Steam Sales (MLBs)	330,033	439,864	453,699	441,791	424,402	346,449
Steam Revenues	\$4,322,168	\$4,418,805	\$4,038,836	\$5,412,228	\$6,743,606	\$3,771,825
Annual Peak (Megawatts)	277.1	266.2	276.2	262.0	258.7	270.4
Total mWh Generated	112,657	38,968	55,396	47,384	20,770	231,848
Total mWh Purchased	1,228,695	1,216,551	1,239,832	1,226,956	1,237,135	1,324,665
Year End Restricted/ Unrestricted Cash & Investment Balance	\$92,950,417	\$94,046,678	\$46,453,195	\$51,201,139	\$60,598,748	\$40,265,406

## WATER

	<u>2018</u>	<u>2017</u>	<u>2016</u>	<u>2015</u>	<u>2014</u>	<u>2008</u> <i>(ten years ago)</i>
<b>RETAIL CUSTOMERS:</b>						
Residential	36,531	36,134	35,736	35,332	34,871	33,044
Industrial / Commercial	3,668	3,614	3,578	3,501	3,459	3,369
Total Retail Customers	40,199	39,748	39,314	38,833	38,330	36,413
<b>RETAIL SALES: (ccf)</b>						
Residential	2,657,659	2,713,284	2,654,992	2,675,696	2,792,307	3,070,783
Industrial / Commercial	2,960,502	3,061,222	3,073,274	2,763,972	2,689,861	2,995,159
Total Retail Sales (ccf)	5,618,161	5,774,506	5,728,266	5,439,668	5,482,168	6,065,942
<b>RETAIL REVENUE:</b>						
Residential	\$5,549,146	\$5,189,102	\$4,768,468	\$4,385,870	\$4,283,619	\$4,221,429
Industrial / Commercial	3,523,158	3,409,516	3,236,888	2,806,087	2,647,654	2,750,234
Public Fire Protection	528,273	522,724	513,738	596,323	571,535	536,192
Total Retail Revenue	\$9,600,577	\$9,121,342	\$8,519,094	\$7,788,280	\$7,502,808	\$7,507,855
Total Pumped (billion gallons)	4.4	4.5	4.5	4.3	4.4	4.8
Year End Restricted/ Unrestricted Cash & Investment Balance	\$9,334,809	\$7,122,783	\$5,705,448	\$4,918,129	\$5,747,264	\$5,332,076

## LEADERSHIP



**Mark Kotschevar**  
General Manager



**Sidney Jackson**  
Director of  
Core Services



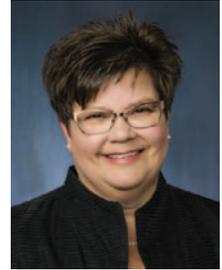
**Peter Hogan**  
Director of  
Corporate Services



**Steve Nyhus**  
Director of  
Compliance and  
Public Affairs



**Jeremy Sutton**  
Director of  
Power Resources



**Krista Boston**  
Director of  
Customer Relations

## UTILITY BOARD



**Mark Browning**  
Board President,  
January–May 2018,  
& Board Member  
Senior Project Manager,  
Facilities Project  
Services  
– Mayo Clinic



**Brian Morgan**  
Board Member &  
Board President,  
June–December 2018  
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

## ADVISORS AND CONSULTANTS

Baker Tilly Virchow Krause, LLP • Independent Auditors  
Kennedy & Graven • Bond Counsel  
Springsted Public Finance Advisors • Financial Advisors

## UTILITY HEADQUARTERS

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