



2015 ANNUAL REPORT

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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, 2015, 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 over financial reporting 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, 2015, 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.

To the Public Utilities Board
Rochester Public Utilities

Emphasis of Matters

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, 2015 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.

As discussed in Note 1, Rochester Public Utilities adopted the provisions of GASB Statement No. 68, *Accounting and Financial Reporting for Pensions – an amendment of GASB Statement No. 27*, and GASB Statement No. 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date – an amendment of GASB Statement No. 68*, effective January 1, 2015. The cumulative effect of the change is shown in the current year. 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 is presented for purposes of additional analysis and is 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 31, 2016 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 Gilly Vichow Krause, LLP

Madison, Wisconsin
March 31, 2016

MANAGEMENT DISCUSSION & ANALYSIS

(Unaudited)

The following discussion and analysis of the financial results of Rochester Public Utilities (RPU or the Utility) provides an overview of the Utility's financial activities for the year ended December 31, 2015 compared to the year ended December 31, 2014.

This discussion is designed to be used in conjunction with the financial statements and notes, which follow this section.

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

Overview of the Financial Statements

Financial Statements

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

Notes to Financial Statements

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

See accompanying *Independent Auditors' Report*.

HIGHLIGHTS

- Rochester continued to grow with 974 new electric customers and 503 new water customers added in 2015. This compares with growth of 418 electric customers and 296 water customers in 2014.
- Electric retail revenues were up 2.4% over 2014, while kilowatt-hour sales were down 0.6%. The increase in revenues was due to a 3.5% overall rate increase effective January 1, 2015. The annual system peak demand of 262 megawatts was set in September, and compares with a peak demand of 259 megawatts in 2014 and the all-time system peak demand of 292 megawatts in 2011.
- Water retail revenues were up 3.8% over 2014, while sales volume was down 0.8%. The increase in revenues was due to a 3.5% rate increase effective January 1, 2015, while the decrease in volume was due in part to an increase in May-through-September rainfall of 10.4% over 2014.
- In 2014, upon completion of an Electric Utility cost-of-service study, the Utility Board and City Council approved a 3-year rate track covering the years 2015 through 2017. The first year's rate increase of 3.5% was effective January 1, 2015. The Utility Board voted for and City Council approved a 3.5% rate increase for the Water Utility, effective January 1, 2015. The rate increases were needed to build cash reserves for the future replacement of infrastructure for the Electric Utility and to support operating, maintenance, and capital activities for both Utilities.
- Rates for power purchased from SMMPA remained steady in 2015, with no increase. Purchased power costs from SMMPA and the MISO market represented 68% of electric operating expenses for 2015.
- In lieu of tax payments of \$8.4 million and \$344,000 were transferred by the Electric and Water Utilities respectively to the City of Rochester's General Fund.
- The wellhouse building for the new Well #41, located at Ridgeline Dr. SE, just east of University Center Rochester, was completed in 2015. Work continues on the process equipment and internal piping so it can begin water production, anticipated in May 2016. The main purpose of this well is to alleviate stress on existing wells in the area that are pumping almost constantly year-round.
- Construction of the St. Bridget water tower began in the summer of 2015. It's located along 50th Street SE, adjacent to Olmsted County Public Works facilities. Erection of the steel tower was completed in late 2015. Painting and electrical work is planned to be completed in the spring and early summer of 2016, with an estimated in-service date of July 2016.
- Installation and configuration of a new Supervisory Control and Data Acquisition (SCADA) system was completed in 2015. This system replaced RPU's existing 17-year-old system and added additional security and functionality for the monitoring and control of the electric and water systems. Cutover to the new system was done on December 1, 2015.

See accompanying *Independent Auditors' Report*.

- Work continued on the CapX2020 project in 2015. Financially, the project is over 90% complete. At the end of 2015 there were 117 miles of transmission line completed and in service, including a 161-kilovolt (kV) transmission line running from the North Rochester Substation to the Northern Hills Substation and a 345kV line running from North Rochester to La Crosse. Another 161kV line running from the North Rochester to the Chester Substation was completed and put in service early in 2016. The remaining 37-mile segment of 345kV line from North Rochester to the Hampton Substation is currently under construction and scheduled to be completed by September 2016. The total cost of the entire project is estimated to come in at \$496 million, which is less than the original budgeted estimate.
- Based on the results of the 2015 update to the Infrastructure Plan, RPU began the development of a 47-megawatt natural gas reciprocating engine generation plant. It will be located on a 50-acre site owned by the Utility on the northwest side of Rochester. The site is currently the location of the Westside Substation and plans are to build the Energy Station adjacent to the existing substation. The Utility executed a contract with Wärtsilä North America, Inc. for the provision of five 9.5-megawatt engines and are in the process of selecting engineers and contractors for installation. The total project is estimated at \$75.0 million and is expected to begin commercial operation in May of 2018.
- May 31, 2015 marked the last day of electrical generation capability for the Silver Lake Power Plant, which had been available to help meet the electrical needs of the residents of Rochester since 1947. In 2012, the RPU Board made the decision to decommission the 100-megawatt, coal-fired steam power plant for purposes of electrical generation on or before December 31, 2015. The plant was decommissioned due to economics and the environmental regulation requirements on older coal-fired plants. Although the facility continues to provide steam to the Mayo Clinic campus under an agreement that runs through 2025 using only natural gas as a fuel source, the electrical generation capability of the Silver Lake facility has been officially decommissioned.
- A Water Utility cost-of-service study was completed in 2015 with the Utility Board and City Council approving a three-year rate track covering the years 2016 through 2018. This new rate track will build cash reserves for the future replacement of infrastructure along with maintaining the financial health of the Water Utility.
- In November 2015, the Utility issued \$40.0 million in revenue bonds. The proceeds from this bond issue were used to refund, in advance, approximately two-thirds of the remaining 2007C bond issue. Due to lower interest rates, RPU was able to realize substantial savings of over \$5.0 million on the refunding.
- RPU once again surpassed its Aggressive Demand-Side Management (DSM) goal for 2015 of 18,540 megawatt hours in energy savings. Actual energy savings of 19,082 megawatt hours were achieved through helping commercial and residential customers install energy efficient equipment and technologies. This represents an estimated 19,082 tons of carbon reduction. The energy savings also represent 1.6% of annual retail energy sales. RPU met 78.2% of its goal of 9.6 million gallons of water saved. Actual savings of 7.5 million gallons 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.

See accompanying *Independent Auditors' Report*.

FINANCIAL ANALYSIS – ELECTRIC UTILITY

Condensed Financial Information – Electric Utility

December 31, 2015 and 2014

(In millions)

Statements of Revenues, Expenses, & Changes in Net Position

	2015	2014	Change 2015 vs. 2014
Operating Revenues	\$145.9	\$142.9	\$3.0
Operating Expenses	127.6	128.3	(0.7)
<i>Operating Income</i>	18.3	14.6	3.7
Other Income & Expense	(0.5)	-	(0.5)
Interest Charges	(3.4)	(3.4)	-
Nonoperating Income (Expense)	(3.9)	(3.4)	(0.5)
<i>Income Before Transfer</i>	14.4	11.2	3.2
Transfers Out (In Lieu Of Tax Payments)	(8.4)	(8.2)	(0.2)
<i>Change in Net Position</i>	6.0	3.0	3.0
Net Position - Beginning of Year	124.7	121.7	3.0
GASB 68 Implementation	(11.2)	-	(11.2)
Adjusted Net Position – Beginning of Year	113.5	121.7	(8.2)
<i>Net Position - End of Year</i>	\$119.5	\$124.7	\$(5.2)

Statements of Net Position

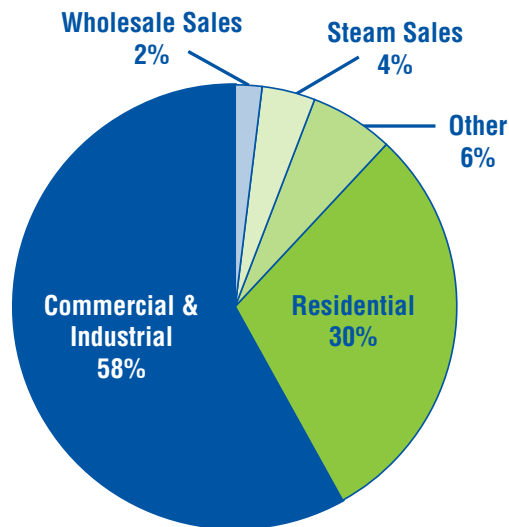
	2015	2014	Change 2015 vs. 2014
Cash and Investments – Unrestricted	\$41.7	\$38.7	\$3.0
Cash and Investments – Restricted	0.7	-	0.7
Other Current Assets	18.9	19.3	(0.4)
Capital Assets, Net	179.0	167.7	11.3
Other Noncurrent Assets	21.1	34.2	(13.1)
<i>Total Assets</i>	261.4	259.9	1.5
Deferred Outflows of Resources	3.8	1.1	2.7
<i>Total Assets Plus Deferred Outflows of Resources</i>	\$265.2	\$261.0	\$4.2
Current Liabilities	\$20.0	\$20.2	\$(0.2)
Long-Term Debt	110.8	114.4	(3.6)
Other Noncurrent Liabilities	13.0	1.1	11.9
<i>Total Liabilities</i>	143.8	135.7	8.1
Deferred Inflows of Resources	1.9	0.6	1.3
Investment in Capital Assets	74.1	71.5	2.6
Restricted – Debt Service	0.3	-	0.3
Restricted – Project Funds Held in Trust	0.7	0.7	-
Unrestricted	44.4	52.5	(8.1)
<i>Net Position</i>	119.5	124.7	(5.2)
<i>Total Liabilities, Deferred Inflows of Resources and Net Position</i>	\$265.2	\$261.0	\$4.2

See accompanying *Independent Auditors' Report*.

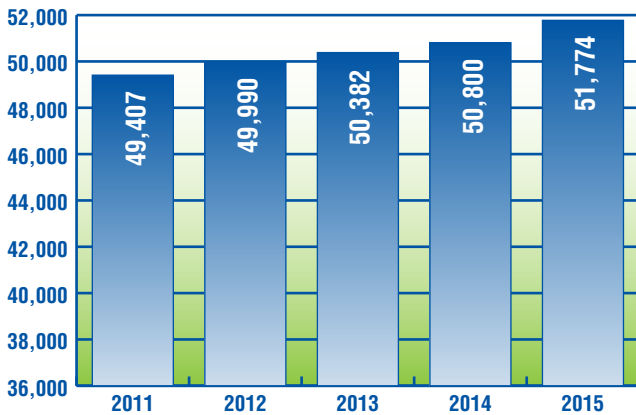
OPERATING REVENUES

Operating revenues increased \$3.0 million (2.0%) in 2015. Retail revenues were up \$3.1 million (2.4%), due primarily to a 3.5% rate increase effective January 1, 2015. Other operating revenues increased \$0.1 million (0.5%). Included in this category was an increase in transmission revenue of \$1.3 million offset by a decrease in steam and wholesale revenues of \$1.6 million (16.7%).

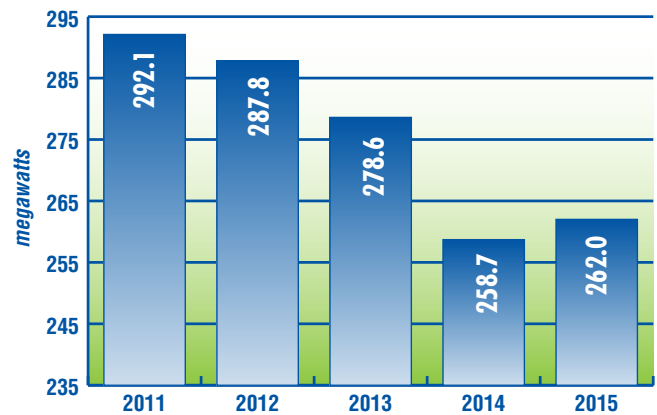
Electric Operating Revenues



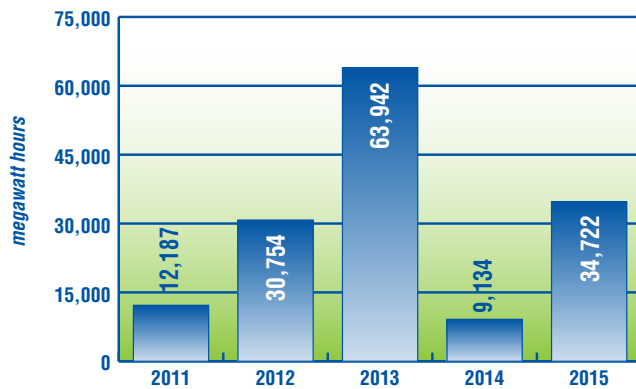
Number of Electric Customers



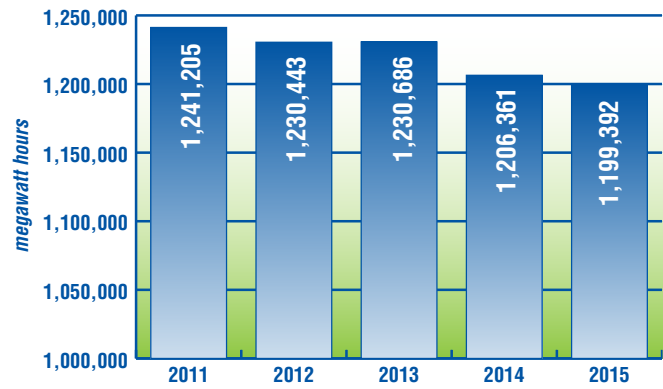
Electric System Peaks



Electric Wholesale Sales



Electric Retail Sales

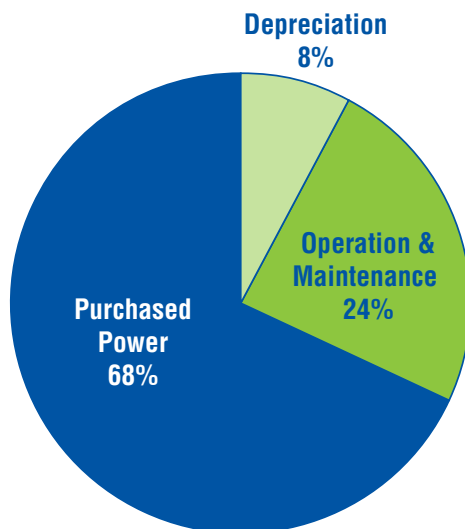


See accompanying *Independent Auditors' Report*.

OPERATING EXPENSES

Operating expenses decreased \$0.7 million (0.6%) in 2015, due primarily to a decrease in purchased power and generation fuel from lower retail kilowatt-hour and wholesale sales. These decreases were partially offset by slight increases in salaries and materials, supplies and outside services. The primary driver of operating expenses for the Electric Utility continues to be purchases of power from SMMPA and the MISO market, which comprised 68% of total operating expenses.

Electric Operating Expenses



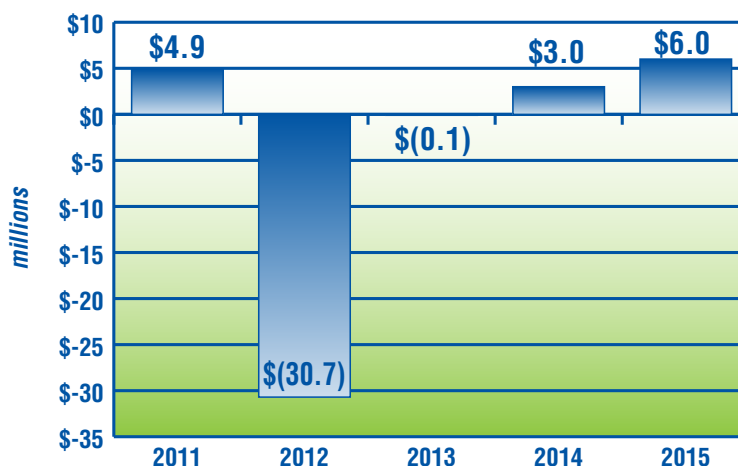
IN LIEU OF TAX PAYMENTS

The Electric Utility transfers an amount to the City of Rochester's General Fund each month based on the amount of retail kilowatt-hours sold. In 2015, despite a small decrease in kilowatt-hour sales, the payment to the City was slightly higher than in 2014 due to an increase in the in lieu of tax rate.

CHANGE IN NET POSITION

The increase in net position for 2015 was \$6.0 million, an improvement of \$3.0 million over 2014. This was due primarily to an increase in retail revenues and decreased operating expenses.

Electric - Change in Net Position

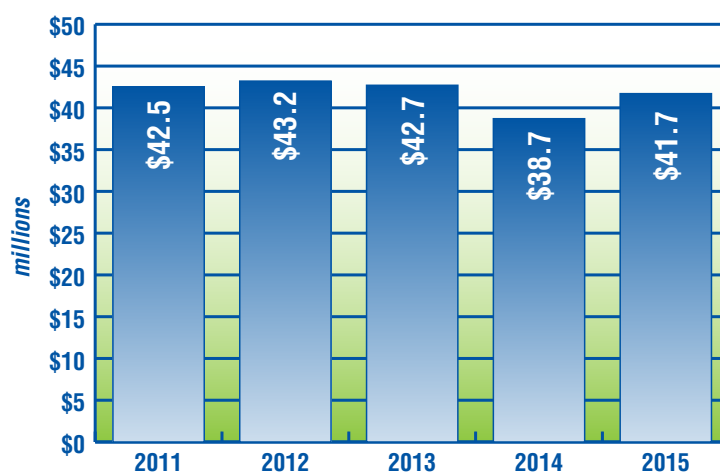


See accompanying *Independent Auditors' Report*.

CASH, INVESTMENTS AND OTHER ASSETS

The ending unrestricted cash and investments balance for 2015 was \$41.7 million, \$3.0 million higher than 2014. The ending restricted cash and investments balance for 2015 was \$0.7 million, with no balance in 2014. This amount represents funds restricted for debt service payments and exists in 2015 due to a change in timing of the accrual for the upcoming debt service payment. Other current assets for 2015 were \$18.9 million, \$0.4 million less than 2014. This decrease was due primarily to a decrease in materials inventory offset by small increases in accrued revenues and prepayments. Other noncurrent assets for 2015 were \$21.1 million, \$13.1 million lower than 2014. This was due to bond proceeds spent on the CapX2020 transmission project.

Electric - Unrestricted Cash & Investments



LIABILITIES

Current liabilities decreased \$0.2 million in 2015, due primarily to a decrease in accrued compensation.

Noncurrent liabilities increased \$11.9 million in 2015 due to implementation of Governmental Accounting Standards Board (GASB) Statement #68. GASB 68 requires the Utility to report a pension liability for its proportionate share of the liability from the Minnesota Public Employees Retirement Association (PERA). The amount reported represents the difference between the actuarially determined benefits owed (total pension liability) and the assets accumulated by the pension plan. Previously employers were required to report pension expense for the required contributions each year. Going forward, pension expense will equal the change in the asset/liability accounts instead of the required contributions.

NET POSITION

Net position invested in capital assets increased \$2.6 million. This increase reflects additions to capital assets funded through rate-based revenues and fees from customers. It also reflects all debt issued to fund capital projects, net of unspent debt proceeds.

Restricted net position increased \$0.3 million. This represents funds restricted for payment of debt service as well as funds contractually committed to the CapX2020 transmission project.

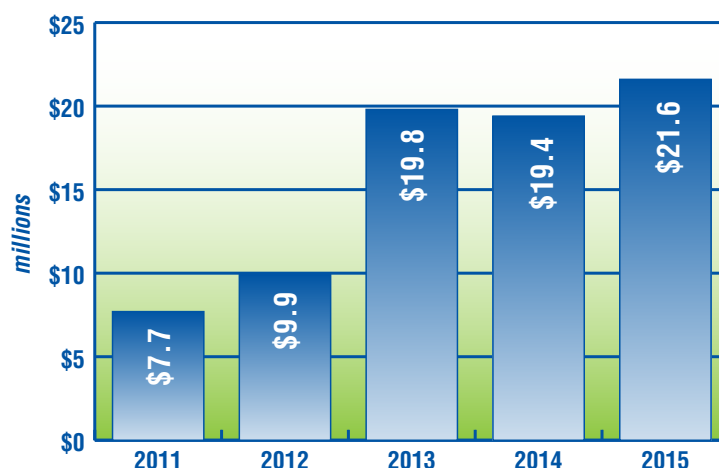
Unrestricted net position is not subject to any constraints by debt covenants or other legal requirements. In 2015, unrestricted net position decreased \$8.1 million due to the results of operations and the recording of pension liability resulting from the implementation of GASB 68.

See accompanying *Independent Auditors' Report*.

CAPITAL ASSETS

At December 31, 2015, the Electric Utility had \$179.0 million invested in a broad range of utility capital assets, including two gas turbines, a hydroelectric power generation plant, two diesel generators, boiler plant and related equipment to provide steam to Mayo Clinic's Prospect Plant, electric transmission and distribution facilities, and various buildings and equipment. Capital assets increased \$20.9 million in 2015, reflecting investments in general facilities and the distribution and transmission systems, a good portion of which was related to the CapX2020 transmission project. The increase in capital assets was offset by a \$9.6 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 and major maintenance expenses increased by \$2.2 million in 2015, due in large part to continued work on the CapX2020 transmission project.

Electric - Capital & Major Maintenance Expenditures



LONG-TERM DEBT

At the end of 2015, the Utility had \$105.3 million in revenue bonds outstanding. New debt in the amount of \$39.97 million was issued in November 2015. This was issued to refund, in advance, a portion of the 2007C bond issue due to the lower interest rate that the 2015 issue will carry. Advance refunding was required because only the bonds maturing after December 1, 2016 are callable. In addition to the new debt issued, \$3.8 million was retired in 2015 and \$42.295 million was defeased in the advance refunding.

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, 2015 and 2014

(In millions)

Statements of Revenues, Expenses, & Changes in Net Position

	2015	2014	Change 2015 vs. 2014
Operating Revenues	\$8.6	\$8.3	\$0.3
Operating Expenses	8.5	8.7	(0.2)
<i>Operating Income</i>	0.1	(0.4)	0.5
Other Income & Expense	-	-	-
Nonoperating Income (Expense)	-	-	-
<i>Income Before Transfers and Capital Contributions</i>	0.1	(0.4)	0.5
Transfers Out (In Lieu Of Tax Payments)	(0.3)	(0.3)	-
Capital Contributions	2.8	2.1	0.7
<i>Change in Net Position</i>	2.6	1.4	1.2
Net Position - Beginning of Year	95.6	94.2	1.4
GASB 68 Implementation	(1.4)	-	(1.4)
Adjusted Net Position – Beginning of Year	94.2	94.2	-
Net Position - End of Year	\$96.8	\$95.6	\$1.2

Statements of Net Position

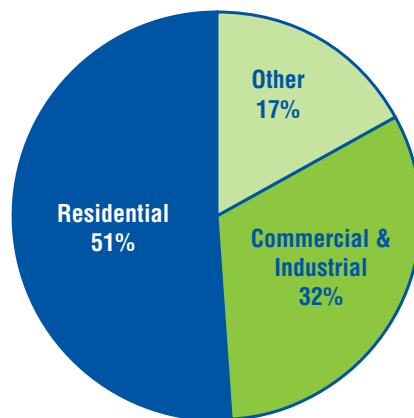
	2015	2014	Change 2015 vs. 2014
Cash and Investments	\$4.9	\$5.8	\$(0.9)
Other Current Assets	0.9	0.6	0.3
Capital Assets, Net	93.9	91.4	2.5
<i>Total Assets</i>	99.7	97.8	1.9
Deferred Outflows of Resources	0.2	-	0.2
<i>Total Assets Plus Deferred Outflows of Resources</i>	\$ 99.9	\$97.8	\$2.1
Current Liabilities	\$1.2	\$1.7	\$(0.5)
Noncurrent Liabilities	1.5	0.1	1.4
<i>Total Liabilities</i>	2.7	1.8	0.9
Deferred Inflows of Resources	0.4	0.4	-
Investment in Capital Assets	93.9	91.4	2.5
Unrestricted	2.9	4.2	(1.3)
<i>Net Position</i>	96.8	95.6	1.2
Total Liabilities, Deferred Inflows of Resources and Net Position	\$99.9	\$97.8	\$2.1

See accompanying Independent Auditors' Report.

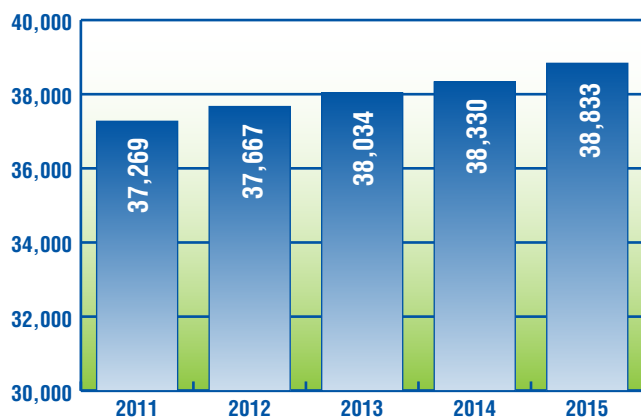
OPERATING REVENUES

Operating revenues increased by \$0.3 million (4.5%) in 2015. Retail revenues were up \$0.3 million (3.8%), due primarily to a 3.5% rate increase effective January 1, 2015.

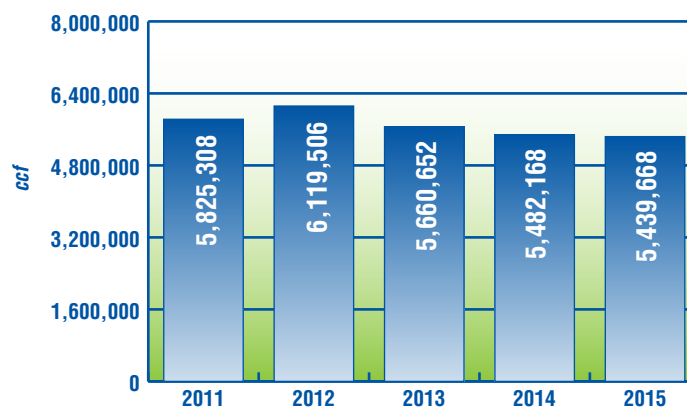
Water Operating Revenues



Number of Water Customers



Water Retail Sales

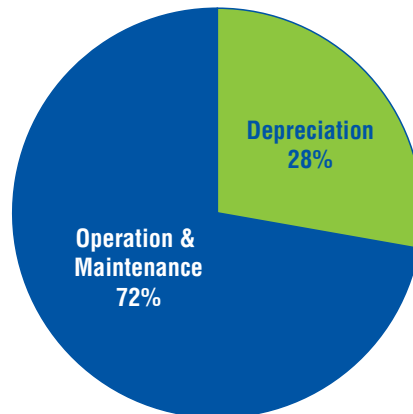


See accompanying *Independent Auditors' Report*.

OPERATING EXPENSES

Operating expenses stayed relatively steady in 2015, with a modest decrease of \$0.2 million (2.1%), driven by a decrease in materials and supplies, employee expenses, and equipment and vehicle expense.

Water Operating Expenses



IN LIEU OF TAX PAYMENTS

The Water Utility transfers an amount to the City of Rochester's General Fund each month based on the amount of retail ccf (hundred cubic feet) sold. In 2015, despite a small decrease in ccf sales, the payment to the City was slightly higher than in 2014 due to an increase in the in lieu of tax rate.

CAPITAL CONTRIBUTIONS

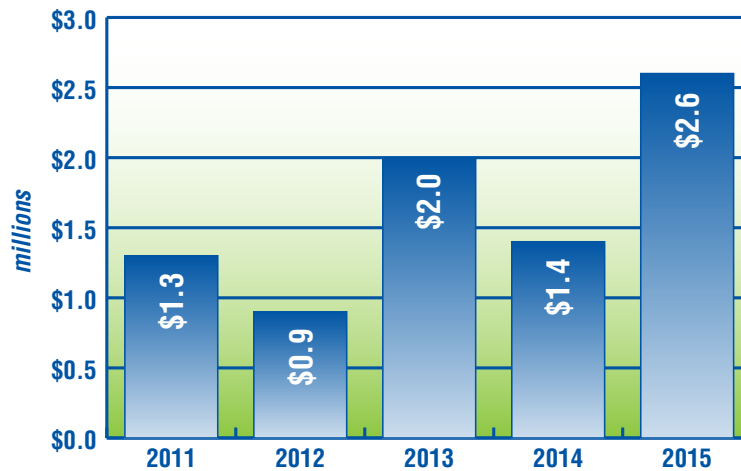
Capital contributions increased \$0.7 million in 2015. These are assets, primarily water mains and fire hydrants, which are contributed to the Water Utility from both the City and developers and are valued using a costing database that estimates their approximate construction costs. Beginning in 2013, 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. The increase in 2015 consists of WAC funds received for reimbursement of the St. Bridget water tower construction costs.

See accompanying *Independent Auditors' Report*.

CHANGE IN NET POSITION

The increase in net position for 2015 was \$2.6 million, \$1.2 million higher than in 2014. This is due to increases in both retail revenues and capital contributions in 2015.

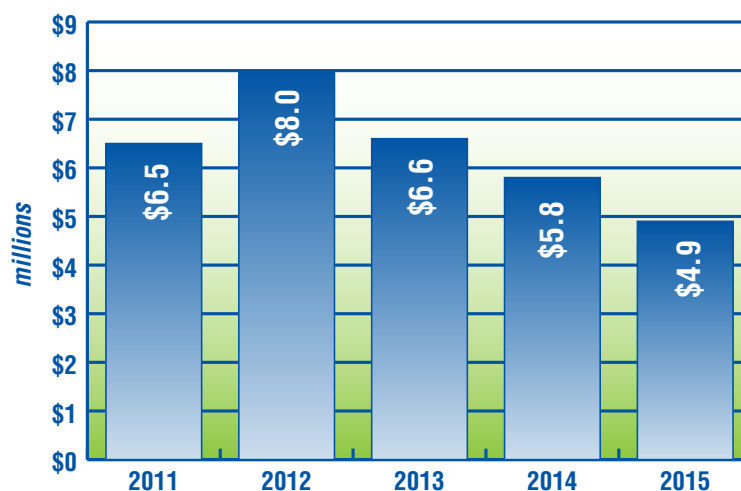
Water - Change in Net Position



CASH, INVESTMENTS AND OTHER ASSETS

The ending unrestricted cash and investments balance for 2015 was \$4.9 million, \$0.9 million lower than 2014.

Water - Unrestricted Cash & Investments



See accompanying *Independent Auditors' Report*.

LIABILITIES

Current liabilities decreased \$0.5 million in 2015 due to a decrease in the amount owed to the City at the end of 2015, partially offset by an increase in accounts payable.

Noncurrent liabilities increased \$1.4 million in 2015 due to implementation of GASB 68. GASB 68 requires the Utility to report a pension liability for its proportionate share of the liability from the Minnesota Public Employees Retirement Association (PERA). The amount reported represents the difference between the actuarially determined benefits owed (total pension liability) and the assets accumulated by the pension plan. Previously employers were required to report pension expense for the required contributions each year. Going forward, pension expense will equal the change in the asset/liability accounts instead of the required contributions.

NET POSITION

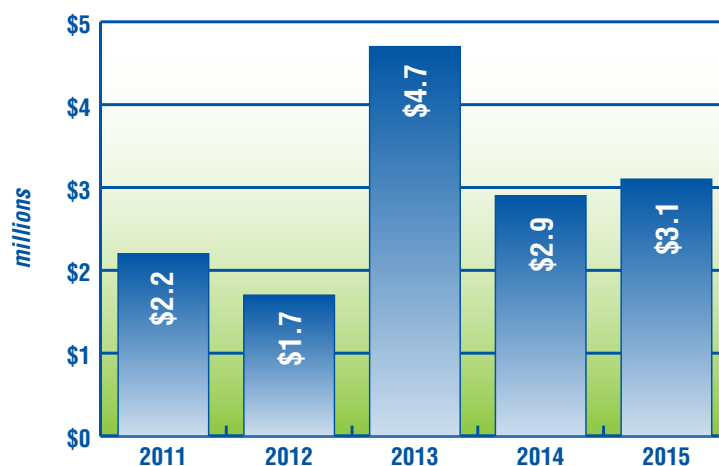
Net position invested in capital assets increased \$2.5 million. This increase reflects additions to capital assets funded through rate-based revenues and fees from customers as well as contributed assets.

Unrestricted net position is not subject to any constraints established by debt covenants or other legal requirements. In 2015, unrestricted net position decreased \$1.3 million due to the results of operations and the recording of pension liability resulting from the implementation of GASB 68.

CAPITAL ASSETS

At December 31, 2015, the Water Utility had \$93.9 million invested in a broad range of utility capital assets, including 19 water storage facilities, 31 wells, water mains, pump station facilities, buildings, and equipment. Capital assets increased \$4.7 million in 2015, 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 \$2.2 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 and major maintenance expenses increased by \$0.2 million in 2015. Some of the major expenditure components in 2015 were work on the new water tower, City projects, well house construction for Well #41, water storage facility maintenance, vehicles and equipment, and metering.

Water - Capital & Major Maintenance 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 2014, the Utility Board approved a 3.5% rate increase for 2015 for the Electric Utility and a 3.5% rate increase for the Water Utility. The rate increases will build cash reserves for future replacement of infrastructure and maintain the financial health of both Utilities. The table below compares historical electric and water rate increases with the annual inflation rate, as well as an average for the last five years.

ROCHESTER PUBLIC UTILITIES ELECTRIC AND WATER RATE CHANGE VERSUS INFLATION

<u>Year</u>	<u>Inflation %</u>	<u>Electric Rates %</u>	<u>Water Rates %</u>
2016	2.0% *	1.7%	6.0%
2015	0.1% *	3.5%	3.5%
2014	1.6%	3.0%	1.5%
2013	1.5%	0.0%	0.0%
2012	2.1%	0.0%	0.0%
Annualized Average	1.5%	1.6%	2.2%

*Estimated Yearly Values

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

The housing market has remained steady. In 2015 there were 371 building permits totaling \$87.5 million issued for single-family homes as compared to 375 permits totaling \$85.5 million in 2014. Commercial building permits increased slightly from 41 in 2014 to 45 in 2015, but the dollar value decreased significantly from \$73.9 million in 2014 to \$44.0 million in 2015.

According to the US Department of Labor Bureau of Labor Statistics, the December 2015 unemployment rate of 2.9% for the area remains well below the state and national rates of 3.7% and 5.0%, respectively. The employment data shows that, on average, there were slightly more people working in the Rochester area than the previous year. During the past 12 months, the average unemployment rate for Rochester was 3.3%.

See accompanying *Independent Auditors' Report*.

The Destination Medical Center (DMC) initiative continues to develop and is projected to have a major impact to the future economic growth of the city. Legislation passed in 2013 required two bodies to be created: the DMC Corporation, an oversight body, and the DMC Economic Development Agency (EDA), a private nonprofit agency that contracts with the DMC Corporation Board to act as its staff, working with the City of Rochester and other stakeholders to develop and execute the DMC plans and strategy. These two groups were organized in 2013 and 2014 and now meet regularly. In March 2014, the EDA began work on the DMC Development Plan, which was adopted by the City of Rochester in March 2015 and by the DMC Corporation in April 2015. The EDA, working with stakeholder organizations and the City of Rochester, is now charged with implementing the DMC Development Plan over the next 20 years. Specifically for Rochester, this will mean the creation of thousands of new jobs and an estimated \$195-\$205 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.

After examining all of these factors in the budgeting process, RPU has projected both electric and water rates to increase modestly over the next five years. As the result of a cost-of-service study completed in 2014, the Electric Utility is currently on a three-year rate track, with rate increases of 3.5%, 1.7% and 1.7%, respectively approved for 2015-2017. As noted in the Highlights section, a cost-of-service study was also completed in 2015 for the Water Utility. This resulted in the RPU Board and City Council approving a three-year rate track with rate increases of 6.0% per year for 2016-2018.

REQUESTS FOR INFORMATION

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

See accompanying *Independent Auditors' Report*.

Electric Utility

Statement of Net Position

As of December 31, 2015

	2015
ASSETS:	
Current Assets:	
Cash and Cash Equivalents	\$5,934,447
Investments	35,763,675
Accounts Receivable and Accrued Utility Revenues	13,746,066
Inventories	4,881,140
Other Current Assets	239,848
Restricted Assets:	
Cash and Cash Equivalents	718,574
Total Current Assets	<u>61,283,750</u>
Noncurrent Assets:	
Restricted Assets:	
Cash and Cash Equivalents	3,128,366
Investments	4,973,028
Funds-Held in Trust	683,050
Capital Assets:	
Construction Work in Progress	33,378,257
Land and Land Rights	4,748,483
Depreciable Assets, Net	140,873,367
Net Capital Assets	<u>179,000,107</u>
Other Assets	<u>12,354,024</u>
Total Noncurrent Assets	<u>200,138,575</u>
Total Assets	<u>261,422,325</u>
DEFERRED OUTFLOWS OF RESOURCES	
Deferred Bond Refunding	2,096,192
Pension Deferred Outflows of Resources	1,659,244
Total Deferred Outflows of Resources	<u>3,755,436</u>
Total Assets Plus Deferred Outflows of Resources	<u>\$265,177,761</u>
LIABILITIES:	
Current Liabilities:	
Accounts Payable	\$10,367,328
Due to the Municipality	2,884,456
Accrued Compensation and Compensated Absences	1,885,769
Customer Deposits	582,359
Current Maturities of Long Term Debt	3,570,415
Current Liabilities Payable from Restricted Assets	
Interest Payable	393,989
Current Maturities of Long Term Debt	324,585
Total Current Liabilities	<u>20,008,901</u>
Noncurrent Liabilities:	
Accrued Compensated Absences	1,226,800
Pre-1968 Pensions Liability	10,000
Net Pension Liability	11,722,132
Long-Term Debt	110,828,414
Total Noncurrent Liabilities	<u>123,787,346</u>
Total Liabilities	<u>143,796,247</u>
DEFERRED INFLOWS OF RESOURCES	
Deferred Revenue	519,695
Pension Deferred Inflows of Resources	1,369,594
Total Deferred Inflows of Resources	<u>1,889,289</u>
NET POSITION:	
Net Investment in Capital Assets	74,080,287
Restricted	
Debt Service	324,583
Funds-Held in Trust	683,050
Unrestricted	<u>44,404,305</u>
Total Net Position	<u>119,492,225</u>
Total Liabilities, Deferred Inflows of Resources and Net Position	<u>\$265,177,761</u>

See accompanying *Notes to Financial Statements*.

Electric Utility

Statement of Revenues, Expenses, and Changes in Net Position

For the Year Ended December 31, 2015

	2015
Operating Revenues:	
Retail	\$133,560,465
Wholesale	2,578,687
Other	9,716,692
Total Operating Revenues	145,855,844
Operating Expenses:	
Purchased Power	86,639,004
Operations and Maintenance	30,339,551
Depreciation	10,186,632
Amortization of Regulatory Assets	402,637
Total Operating Expenses	127,567,824
Operating Income	18,288,020
Nonoperating Income (Expenses):	
Investment Income	239,919
Interest Expense	(3,421,290)
Amortization of Regulatory Assets	(73,211)
Miscellaneous, Net	(610,054)
Total Nonoperating (Expenses)	(3,864,636)
Income Before Transfers	14,423,384
Transfers Out	(8,383,748)
Change in Net Position	6,039,636
Net Position, Beginning of Year	124,655,896
Cumulative Effect of a Change in Accounting Principle, GASB Statement No. 68	(11,203,307)
Net Position, Beginning of Year, as adjusted	113,452,589
Net Position, End of Year	\$119,492,225

See accompanying *Notes to Financial Statements*.

Electric Utility

Statement of Cash Flows

For the Year Ended December 31, 2015

	2015
Cash Flows From Operating Activities:	
Cash Received from Customers	\$141,691,796
Cash Paid to Suppliers	(104,387,652)
Cash Paid to Employees	(14,296,693)
Internal Activity - Payments From Other Funds	5,726,550
Service Territory Acquisition	(421,982)
Net Cash Provided By Operating Activities	28,312,019
Cash Flows From Noncapital Financing Activities:	
Operating Transfers to Other Funds	(8,379,624)
Cash Flows From Capital and Related Financing Activities:	
Additions to Utility Plant and Other Assets	(20,394,704)
Payments on Bonds and Notes Payable Obligations	(9,170,490)
Net Cash (Used In) Capital and Related Financing Activities	(29,565,194)
Cash Flows From Investing Activities:	
Interest Received	235,190
Investment Purchases	(13,019,784)
Investment Redemptions	10,942,561
Net Cash (Used In) Investing Activities	(1,842,033)
Net (Decrease) in Cash and Cash Equivalents	(11,474,832)
Cash and Cash Equivalents, Beginning of Year	21,256,219
Cash and Cash Equivalents, End of Year	9,781,387
Classified As:	
Current Assets	5,934,447
Restricted Assets	3,846,940
Cash and Cash Equivalents, End of Year	\$9,781,387

	2015
Reconciliation of Operating Income to Net Cash Provided by Operating Activities:	
Operating Income	\$18,288,020
Adjustments to Reconcile Operating Income to	
Net Cash Provided by Operating Activities:	
Depreciation and Amortization	10,589,269
Bad Debts	175,353
Service Territory Payments	(421,982)
Miscellaneous Income	(610,054)
Interest Expense, Customer Deposits	(576)
(Increase) Decrease In:	
Accounts Receivable and Accrued Utility Revenues	(326,696)
Inventories	786,807
Other Current Assets	(216,971)
Increase (Decrease) In:	
Accrued Liabilities and Accounts Payable	397,809
Customer Deposits	(22,890)
Unearned Lease Revenues	(36,420)
Pension Deferred Outflow/Inflow	(289,650)
Net Cash Provided by Operating Activities	\$28,312,019

See accompanying *Notes to Financial Statements*.

Water Utility

Statement of Net Position

As of December 31, 2015

	2015
ASSETS:	
Current Assets:	
Cash and Cash Equivalents	\$771,404
Investments	4,146,725
Accounts Receivable and Accrued Utility Revenues	791,674
Materials and Supplies Inventory	153,354
Total Current Assets	5,863,157
Noncurrent Assets:	
Capital Assets:	
Construction Work in Progress	3,721,035
Land and Land Rights	677,486
Depreciable Assets, Net	89,473,716
Net Capital Assets	93,872,237
Total Noncurrent Assets	93,872,237
Total Assets	99,735,394
DEFERRED OUTFLOWS OF RESOURCES	
Pension Deferred Outflows of Resources	197,756
Total Assets Plus Deferred Outflows of Resources	\$99,933,150
LIABILITIES:	
Current Liabilities:	
Accounts Payable	\$666,850
Due to the Municipality	189,891
Accrued Compensation and Compensated Absences	292,552
Customer Deposits	52,493
Total Current Liabilities	1,201,786
Noncurrent Liabilities:	
Accrued Compensated Absences	175,379
Net Pension Liability	1,400,562
Total Noncurrent Liabilities	1,575,941
Total Liabilities	2,777,727
DEFERRED INFLOWS OF RESOURCES	
Deferred Revenue	206,262
Pension Deferred Inflows of Resources	163,639
Total Deferred Inflows of Resources	369,901
NET POSITION:	
Net Investment in Capital Assets	93,872,237
Unrestricted	2,913,285
Total Net Position	96,785,522
Total Liabilities, Deferred Inflows of Resources and Net Position	\$99,933,150

See accompanying *Notes to Financial Statements*.

Water Utility

Statement of Revenues, Expenses, and Changes in Net Position

For the Year Ended December 31, 2015

	2015
Operating Revenues:	
Retail	\$7,788,280
Other	872,626
Total Operating Revenues	<u>8,660,906</u>
Operating Expenses:	
Operations and Maintenance	6,110,462
Depreciation	2,416,580
Total Operating Expenses	<u>8,527,042</u>
Operating Income	<u>133,864</u>
Nonoperating Income (Expenses):	
Investment Income	53,274
Interest Expense	(6)
Miscellaneous, Net	(66,666)
Total Nonoperating (Expense)	<u>(13,398)</u>
Income Before Transfers and Capital Contributions	<u>120,466</u>
Transfers Out	(344,059)
Capital Contributions	2,818,359
Change in Net Position	<u>2,594,766</u>
Net Position, Beginning of Year	95,583,933
Cumulative Effect of a Change in Accounting Principle, GASB Statement No. 68	(1,393,177)
Net Position, Beginning of Year, as adjusted	<u>94,190,756</u>
Net Position, End of Year	<u><u>\$96,785,522</u></u>

See accompanying *Notes to Financial Statements*.

Water Utility

Statement of Cash Flows

For the Year Ended December 31, 2015

	2015
Cash Flows From Operating Activities:	
Cash Received from Customers	\$7,902,176
Cash Paid to Suppliers	(4,755,350)
Cash Paid to Employees	(1,680,383)
Internal Activity - Payments From Other Funds	196,866
Net Cash Provided By Operating Activities	1,663,309
Cash Flows From Noncapital Financing Activities:	
Operating Transfers to Other Funds	(341,655)
Cash Flows From Capital and Related Financing Activities:	
Additions to Utility Plant and Other Assets	(2,945,871)
Capital Contributions Received	741,815
Net Cash (Used In) Capital and Related Financing Activities	(2,204,056)
Cash Flows From Investing Activities:	
Interest Received	53,267
Investment Purchases	(258,935)
Investment Redemptions	1,027,603
Net Cash Provided by Investing Activities	821,935
Net (Decrease) in Cash and Cash Equivalents	(60,467)
Cash and Cash Equivalents, Beginning of Year	831,871
Cash and Cash Equivalents, End of Year	\$771,404

	2015
Reconciliation of Operating Income to Net Cash Provided by Operating Activities:	
Operating Income	\$133,864
Adjustments to Reconcile Operating Income to Net Cash Provided by Operating Activities:	
Depreciation	2,416,580
Bad Debts	9,419
Other	(66,666)
(Increase) Decrease In:	
Accounts Receivable and Accrued Utility Revenues	(311,128)
Materials and Supplies Inventory	(7,101)
Increase (Decrease) In:	
Accrued Liabilities and Accounts Payable	(296,024)
Customer Deposits	(31,566)
Unearned Revenue	(149,952)
Pension Deferred Outflow/Inflow	(34,117)
Net Cash Provided by Operating Activities	\$1,663,309
Non-Cash Capital and Related Financing Activities:	
Additions to Utility Plant and Other Assets Contributed By:	
City's Governmental Funds	\$282,486
Developers	\$1,794,058

See accompanying *Notes to Financial Statements*.

NOTES TO FINANCIAL STATEMENTS

As of and for the Year Ended December 31, 2015

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 account 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.

GASB issued Statement No. 68 - *Accounting and Financial Reporting for Pensions - an amendment of GASB Statement No. 27* and Statement No. 71 - *Pension Transition for Contributions Made Subsequent to the Measurement Date - an amendment of GASB Statement No. 68*, in June 2012 and November 2013, respectively. These statements establish accounting and financial reporting standards for the accounting and reporting to the Utilities' cost-sharing multiple employer pension plan. This statement replaces the requirements of Statement No. 27, *Accounting for Pensions by State and Local Governmental Employer*. The Utilities adopted these statements effective January 1, 2015. The cumulative impact of implementation is shown in Note 11.

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, liabilities and deferred inflows 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. Fair values are based on quoted market prices. 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. Market values may have changed significantly after year end.

Investment of utility funds is 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.

As a department of the City of Rochester, MN, the utility is 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 \$200,000 for the Electric Utility and \$20,000 for the Water Utility for December 31, 2015.

Revenues are recognized on the accrual basis of accounting and include estimated amounts for service rendered but not billed. Accrued revenue amounts are \$5,743,746 for the Electric Utility and \$164,486 for the Water Utility for the year ended December 31, 2015.

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

Electric Plant	Years
Generation	10-60
Transmission	20-45
Distribution	10-50
General	5-50

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

Other Assets – Noncurrent

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

A summary of changes in electric other assets for 2015 follows:

	<u>Balance 1/1/15</u>	<u>Increases</u>	<u>Decreases</u>	<u>Balance 12/31/15</u>
Bond issue costs	\$1,515,230	\$332,228	\$201,885	\$1,645,573
Less: Amortization of bond issue costs	822,227	73,211	-	895,438
Non-Operating Other Assets	693,003			750,135
Regulatory asset-Service territory payments	15,609,489	415,873	-	16,025,362
Less: Amortization of Regulatory asset	4,018,836	402,637	-	4,421,473
Operating Other Assets	11,590,653			11,603,889
Net Other Assets	<u>\$12,283,656</u>			<u>\$12,354,024</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, 2015 is \$2,096,192.

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.

Accrued Claims

Under a one-time offer of Retirement/Resignation Incentive Program made available to eligible employees in the Power Resources Division, the Utilities paid a lump-sum amount equal to one week of base wages for each full year of employment to each participating employee upon separation. All of the participating employees retired in 2015 or earlier and received their separation payments.

Long-Term Debt

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

Deferred Inflows of Resources

The Electric Utility leases a portion of its transmission system, known as the North Loop, to Southern Minnesota Municipal Power Agency (SMPMA) under a non-cancelable operating lease through the year 2030. The Utility is responsible for all operating and maintenance costs. The Utility received a lump sum payment of \$1,500,000 in 1989 and lease revenues are being recognized ratably over the lease term. The amount deferred as of December 31, 2015 was \$519,695.

The Water Utility has received advance payments for leasing antenna space on its water towers. These payments for 2015 were \$206,262.

Pensions

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

REVENUES AND EXPENSES

The Utilities distinguishes operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a utility's 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 rates were approved by the Utility Board and the City Council and placed into effect on January 1, 2015.

Current water rates were approved by the Utility Board and the City Council and placed into effect on January 1, 2015.

Transfers

Transfers include the payment in lieu of taxes to the municipality.

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 \$22,222,817 (\$16,810,589 Retail and \$5,412,228 Other) in 2015. 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. 72, *Fair Value Measure and Application*, Statement No. 73, *Accounting and Financial Reporting for Pensions and Related Assets That Are Not within the Scope of GASB Statement 68, and Amendments to Certain Provisions of GASB Statements 67 and 68*, Statement No. 74, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*, Statement No. 76, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*, Statement No. 78, *Pensions Provided through Certain Multiple-Employer Defined Benefit Pension Plans*, and Statement No. 79, *Certain External Investment Pools and Pool Participants*. 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 and associated risks are disclosed in the notes to the City of Rochester's basic financial statements included in the City's 2015 Comprehensive Annual Financial Report.

NOTE 3: Due to the Municipality

The following is a schedule of balances as of December 31, 2015:

<u>Due To</u>	<u>Due From</u>	<u>Principal Purpose</u>	<u>2015 Amount</u>
Municipality	Electric	General operating	\$27,733
Municipality	Electric	Electric construction projects	151,259
Municipality	Electric	Payments in lieu of tax	678,067
Municipality	Electric	Sewer and Storm water revenue	2,646,148
Total Electric Due To Municipality			3,503,207
Electric	Municipality	Sewer and Storm water billing fees	109,950
Electric	Municipality	Utility bills	395,177
Electric	Municipality	Utility bill collections	52
Electric	Municipality	General operating	502
Electric	Municipality	Interest on investments	113,070
Total Electric Due From Municipality			618,751
Electric Net Due to Municipality			\$2,884,456
Municipality	Water	General operating	\$1,023
Municipality	Water	Water reconstruction projects	417,021
Municipality	Water	Street opening repairs	41,218
Municipality	Water	Payments in lieu of tax	24,748
Total Water Due To Municipality			484,010
Water	Municipality	Utility bills	9,017
Water	Municipality	WAC Funds	283,766
Water	Municipality	General operating	1,336
Total Water Due From Municipality			294,119
Water Net Due to Municipality			\$189,891

The following is a schedule of transfer balances for the year ending December 31, 2015:

<u>To</u>	<u>From</u>	<u>Principal Purpose</u>	<u>2015 Amount</u>
Municipality	Electric	Tax Equivalents	\$8,383,748
Municipality	Water	Tax Equivalents	\$344,059

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:

2015

Current Restricted Assets

Debt Service Account

\$718,574

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

Noncurrent Restricted Assets

Construction Fund

\$3,128,366

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

Reserve Account

4,973,028

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

Funds-Held in Trust

683,050

Funds to be used for CapX2020 expenses.

Total Noncurrent Restricted Assets

\$8,784,444

NOTE 5: Changes in Capital Assets

ELECTRIC

A summary of changes in electric capital assets for 2015 follows:

	Balance 1/1/15	Increases	Decreases	Balance 12/31/15
Capital assets, not being depreciated:				
Construction in progress	\$32,364,447	\$14,811,502	\$13,797,692	\$33,378,257
Land and land rights	3,722,539	1,025,944	-	4,748,483
Total capital assets, not being depreciated	36,086,986	15,837,446	13,797,692	38,126,740
Capital assets, being depreciated:				
Buildings, structures and improvements	34,668,658	1,256,767	12,875	35,912,550
Installations, equipment and fixtures	280,610,773	18,830,476	1,218,917	298,222,332
Total capital assets, being depreciated	315,279,431	20,087,243	1,231,792	334,134,882
Less: Accumulated depreciation	183,700,045	10,186,632	625,162	193,261,515
Depreciable Assets, Net	131,579,386			140,873,367
Net Capital Assets	\$167,666,372			\$179,000,107

WATER

A summary of changes in water capital assets for 2015 follows:

	Balance 1/1/15	Increases	Decreases	Balance 12/31/15
Capital assets, not being depreciated:				
Construction in progress	\$4,293,389	\$2,582,547	\$3,154,901	\$3,721,035
Land and land rights	816,332	-	138,846	677,486
Total capital assets, not being depreciated	5,109,721	2,582,547	3,293,747	4,398,521
Capital assets, being depreciated:				
Buildings, structures and improvements	17,344,423	9,832	-	17,354,255
Installations, equipment and fixtures	110,484,822	5,700,582	292,402	115,893,002
Total capital assets, being depreciated	127,829,245	5,710,414	292,402	133,247,257
Less: Accumulated depreciation	41,524,343	2,416,580	167,382	43,773,541
Depreciable Assets, Net	86,304,902			89,473,716
Net Capital Assets	\$91,414,623			\$93,872,237

In 2015, capital assets totaling \$282,486 were contributed to the Utility by other funds of the City of Rochester, and \$1,794,058 was contributed to the Utility by others.

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

The following revenue bonds and notes have been issued:

Date	Purpose	Final Maturity	Interest Rate	Original Amount	Outstanding Amount 12/31/15
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	\$39,970,000
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	\$37,700,000
3/19/07	Revenue Bond Series 2007C-Emission reduction equipment at Silver Lake Plant, transmission and substation work, distribution system expansion, and advance refund of Series 2000A Bonds	12/1/30	4.00-5.00%	76,680,000	26,060,000
2/26/13	Revenue Bond Series 2013A-Refund 2002 issue	12/1/17	2.00%	3,960,000	1,605,000

Revenue bond debt service requirements to maturity follows:

<u>Year Ending December 31</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2016	\$3,895,000	\$4,665,596	\$8,560,596
2017	3,935,000	4,446,050	8,381,050
2018	4,305,000	4,292,450	8,597,450
2019	4,510,000	4,084,550	8,594,550
2020	4,730,000	3,869,363	8,599,363
2021-2025	27,160,000	15,843,238	43,003,238
2026-2030	33,345,000	9,661,000	43,006,000
2031-2035	7,520,000	4,735,300	12,255,300
2036-2040	9,260,000	2,988,100	12,248,100
2041-2043	6,675,000	678,500	7,353,500
	<u>\$105,335,000</u>	<u>\$55,264,147</u>	<u>\$160,599,147</u>

All utility revenues net of specified operating expenses are pledged as security of the above revenue bonds until the bonds are defeased. Principal and interest paid for 2015 was \$51,150,525 which consisted of \$8,855,525 of scheduled principal and interest payments and \$42,295,000 to advance refund and defease a portion of the outstanding bonds from the 2007C Issue. Total gross revenues as defined for the same period were \$146,095,763. Annual principal and interest payments are expected to require 6% of gross revenues on average.

On November 17, 2015, bonds in the amount of \$39.97 million were issued with an average interest rate of 4.11% to advance refund \$42.295 million of outstanding bonds with an average interest rate of 4.57%. The cash flow requirements on the old bonds prior to the advance refunding was \$60,725,925 from 2016 through 2030. The cash flow requirements on the new bonds are \$54,021,746 from 2016 to 2030. The advance refunding resulted in an economic gain of \$5,227,065.

LONG-TERM OBLIGATIONS SUMMARY - ELECTRIC

Long-term obligation activity for the year ended December 31, 2015 is as follows:

	<u>1/1/15</u> <u>Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>12/31/15</u> <u>Balance</u>	<u>Due Within</u> <u>One Year</u>
Long-term debt	\$111,425,000	\$39,970,000	\$46,060,000	\$105,335,000	\$3,895,000
Bond discount/premium	6,778,372	4,288,770	1,678,728	9,388,414	-
Accrued Compensated Absences	1,083,693	245,059	101,952	1,226,800	-
Pre-1968 Pension Liability	13,000	-	3,000	10,000	-
Power Resources Retirement Incentive	49,223	-	49,223	-	-
Net Pension Liability	-	11,722,132	-	11,722,132	-
Totals	<u>\$119,349,288</u>	<u>\$56,225,961</u>	<u>\$47,892,903</u>	<u>\$127,682,346</u>	<u>\$3,895,000</u>

LONG-TERM OBLIGATIONS SUMMARY - WATER

Long-term obligation activity for the year ended December 31, 2015 is as follows:

	<u>1/1/15 Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>12/31/15 Balance</u>
Accrued Compensated Absences	\$151,991	\$23,388	-	\$175,379
Net Pension Liability	-	1,400,562	-	1,400,562
Totals	<u>\$151,991</u>	<u>\$1,423,950</u>	<u>-</u>	<u>\$1,575,941</u>

INTEREST EXPENSE - ELECTRIC

	<u>2015</u>
Bond interest expense	\$5,060,306
Bond premium & discount amortization	(485,796)
Interest expense	575
Allowance for funds used during construction	(1,153,795)
Totals	<u>\$3,421,290</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

DEFINED BENEFIT PENSION PLANS

The Utilities implemented GASB Statement No. 68, *Accounting and Financial Reporting for Pensions – an amendment of GASB Statement No. 27*, and GASB Statement No. 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date – an amendment of GASB Statement No. 68*, effective January 1, 2015. The cumulative effect of the change in net position due to the change in accounting standard is shown as a change in beginning net position for 2015.

A. Plan Description

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

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

Benefits Provided

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

Benefit increases are provided to benefit recipients each January. Increases are related to the funding ratio of the plan. Members in a plan that are at least 90% funded for two consecutive years are given a 2.50% increase. Members in a plan that has not exceeded 90% funded, or has fallen below 80%, are given a 1.00% increase.

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

Benefits are based on a member's highest average salary for any five successive years of allowable service, age, and years of credit at termination of service. Two methods are used to compute benefits for PERA's Coordinated Plan members. The retiring member receives the higher of a step-rate benefit accrual formula (Method 1) or a level accrual formula (Method 2). Under Method 1, the annuity accrual rate for a Coordinated Plan member is 1.20% of average salary for each of the first ten years and 1.70% for each remaining year. Under Method 2, the annuity accrual rate is 1.70% for Coordinated Plan members for each year of service. For members hired prior to July 1, 1989, a full annuity is available when age plus years of service equal 90 and normal retirement age is 65. For members hired on or after July 1, 1989, normal retirement age is the age for unreduced Social Security benefits capped at 66.

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 6.50% of their annual covered salary in calendar year 2015. The Utilities were required to contribute 7.50% for Coordinated Plan members in calendar year 2015. The Utilities' contributions to the GERP for the year ended December 31, 2015, were \$1,053,611 and \$125,932 for the Electric Utility and Water Utility respectively. The Utilities' contributions were equal to the required contributions as set by state statute.

B. Pension Costs

At December 31, 2015, the Electric Utility reported a liability of \$11,722,132, and the Water Utility reported a liability of \$1,400,562 as each utility's allocated share of the City of Rochester's proportionate share of \$38,402,466 of the GERP's net pension liability. The net pension liabilities were measured as of June 30, 2015, and the total pension liabilities used to calculate the net pension liabilities were determined by an actuarial valuation as of that date. The City of Rochester's net pension liability was based on the City's contributions received by PERA during the measurement period for employer payroll paid dates from July 1, 2014, through June 30, 2015, relative to the total employer contributions received from all of PERA's participating employers. At June 30, 2015, the City's proportion share was 0.7410% which was a decrease of 0.0724% from its proportion measured as of June 30, 2014.

For the year ended December 31, 2015, the Electric Utility and Water Utility recognized pension expense of \$1,302,998 and \$155,682 respectively as allocated shares of the City of Rochester's GERP pension expense.

At December 31, 2015, the Electric Utility reported its allocated share of the City of Rochester's GERP deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

	<u>Deferred Outflows of Resources</u>	<u>Deferred Inflows of Resources</u>
Differences between expected and actual economic experience	-	\$588,925
Changes in actuarial assumptions	-	-
Difference between projected and actual investment earnings	\$1,109,680	-
Changes in proportion	-	780,669
Contributions paid to PERA subsequent to the measurement date	549,564	-
Total	<u>\$1,659,244</u>	<u>\$1,369,594</u>

\$549,564 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, 2016. 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
2016	(\$179,111)
2017	(179,111)
2018	(179,112)
2019	277,420

At December 31, 2015, the Water Utility reported its allocated share of the City of Rochester's GERS deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

	<u>Deferred Outflows of Resources</u>	<u>Deferred Inflows of Resources</u>
Differences between expected and actual economic experience	-	\$70,365
Changes in actuarial assumptions	-	-
Difference between projected and actual investment earnings	\$132,585	-
Changes in proportion	-	93,274
Contributions paid to PERA subsequent to the measurement date	65,171	-
Total	<u>\$197,756</u>	<u>\$163,639</u>

\$65,171 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, 2016. 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
2016	(\$21,400)
2017	(21,400)
2018	(21,401)
2019	33,147

C. Actuarial Assumptions

The total pension liability in the June 30, 2015, actuarial valuation was determined using the following actuarial assumptions:

Inflation	2.75% per year
Active Member Payroll Growth	3.50% per year
Investment Rate of Return	7.90%

Salary increases were based on a service-related table. Mortality rates for active members, retirees, survivors and disabilitants were based on RP-2000 tables for males or females, as appropriate, with slight adjustments. Cost of living benefit increases for retirees are assumed to be: 1% effective every January 1st until 2034, then 2.5%.

Actuarial assumptions used in the June 30, 2015, valuation were based on the results of actuarial experience studies. The experience study in the GERP was for the period July 1, 2004, through June 30, 2008, with an update of economic assumptions in 2014.

There were no changes in actuarial assumptions in 2015.

The long-term expected rate of return on pension plan investments is 7.90%. The State Board of Investment, which manages the investments of PERA, prepares an analysis of the reasonableness of the long-term expected rate of return on a regular basis 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 arithmetic 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	45%	5.50%
International Stocks	15%	6.00%
Bonds	18%	1.45%
Alternative Assets	20%	6.40%
Cash	2%	0.50%

D. Discount Rate

The discount rate used to measure the total pension liability was 7.90%. The projection of cash flows used to determine the discount rate assumed that employee and employer contributions will be made at the rate specified in statute. Based on that assumption, each of the pension plan's fiduciary net position was projected to be available to make all projected future benefit payments of current active and inactive employees. 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.

E. Pension Liability Sensitivity

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

	1% Decrease in Discount Rate (6.9%)	Discount Rate (7.9%)	1% Increase in Discount Rate (8.9%)
Electric Utility's allocated share of the GERP net pension liability:	\$18,431,358	\$11,722,132	\$6,181,342
Water Utility's allocated share of the GERP net pension liability:	\$2,202,181	\$1,400,562	\$738,548

F. Pension Plan Fiduciary Net Position

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

G. 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, 2015 was \$35,614.

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 \$275,000 per claim with a variable annual aggregate, and the 2015 workers' compensation coverage is limited to \$980,000 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 2015 Comprehensive Annual Financial Report.

NOTE 10: Accounting for the Effects of Rate Regulation

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

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

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

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

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

NOTE 11: Cumulative Effect of a Change in Accounting Principle

The Utilities adopted GASB Statement No. 68 effective January 1, 2015. The cumulative effect of implementation is reflected as a change in net position as follows:

	Electric Utility	Water Utility
Net pension liability, January 1, 2015	(\$11,673,687)	(\$1,445,988)
Deferred outflows, January 1, 2015	470,380	52,811
Cumulative Effect of a Change in Accounting Principle	(\$11,203,307)	(\$1,393,177)

NOTE 12: Commitments and Contingencies

POWER SALES AGREEMENT

The Electric Utility had two agreements with the Minnesota Municipal Power Agency (MMPA) to sell a maximum 100 megawatts of power annually from its Silver Lake Plant to MMPA. Under the terms of the agreements, 100 megawatts of power was sold at fixed rates for providing the availability of generating capacity. The Utility was reimbursed for the fuel-related costs of generating power for one quarter of the energy production. The remaining three quarters of the energy produced was sold into the Midcontinent Independent System Operator (MISO) market at market-based rates adjusted for SO2 allowance consumption under a margin-sharing arrangement. The Utility had an additional agreement with MMPA to market energy from its Cascade Creek combustion turbines (approximately 82 megawatts) into the MISO market, also under a margin-sharing arrangement. These agreements ended May 31, 2015.

Revenue under these agreements for the year ended December 31, 2015 were as follows:

	2015
kWh provided	1,980,995
Payments for availability	\$679,652
Market-based sales	\$140,688

Effective June 1, 2015 the Utility has a Resource Management Agreement with The Energy Authority, Inc. as its market participant in the MISO energy and operating reserves market for the Cascade Creek combustion turbines.

SERVICE TERRITORY SETTLEMENTS

Under settlement agreements with People’s Energy Cooperative (PEC), the Electric Utility is required to make payments to PEC related to the acquisitions of certain electric service rights from PEC. The payment is based on kilowatt hours (kWh) sold in acquired areas and varies by each settlement agreement. The kWh compensation rate ranges from 12.73 mills (tenths of a cent) per kWh to 16.46 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 1,220,607,409 kilowatt hours totaling \$85,873,398 from SMMPA during the year ended December 31, 2015.

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

CAPX2020

Since 2007, the Utility has participated in the CapX2020 initiative, a joint initiative among midwest utilities intended to expand the transmission grid through construction of transmission lines primarily in Minnesota, Wisconsin and the surrounding region.

In December 2012, the Utility Board and City Council approved the Project Agreements for the Utility's participation in the La Crosse Project portion of the CapX2020 initiative which consists of plans to build a 345 kilovolt (kV) line from Hampton, MN to Rochester, MN and on to La Crosse, WI. The project includes a transmission substation near Rochester where two associated 161 kV lines are routed to the Utility's Northern Hills and Chester Substations. Five utilities have an ownership interest in the La Crosse Project. The other participants in the La Crosse Project are Dairyland Power Cooperative (DPC), Northern States Power Company, a Minnesota corporation (NSP-MN), Northern States Power Company, a Wisconsin corporation (NSP-WI), SMMPA, and Wisconsin Public Power, Inc. (WPPI).

The La Crosse transmission line will improve reliability for the Twin Cities, Rochester and La Crosse areas, as well as improve access to generation in the southern part of Minnesota. The Utility is sharing in the project cost based on its load ratio shared between the five participating utilities, which is calculated to be 9% or approximately \$44.4 million. Construction began in 2013 and is expected to be completed in September 2016. NSP-MN is acting as the Construction Manager for the La Crosse Project and administers a trust account where the five participating utilities make required deposits based on expenditure plans provided by the Construction Manager, and from which the Construction Manager withdraws funds as construction expenditures occur. RPU had \$683,050 on deposit in the trust account as of December 31, 2015.

OPEN CONSTRUCTION CONTRACTS AND OTHER SIGNIFICANT COMMITMENTS

The Utilities have several active projects and agreements as of December 31, 2015. At year end, the Utilities' significant commitments are as follows:

<u>Electric Projects</u>	<u>Spent-to-Date</u>	<u>Remaining Commitment</u>
CapX2020	\$37,079,425	\$5,809,173
SCADA System	645,558	187,762
Customer Communication	266,000	646,562
West Side Energy Station	129,600	22,585,247
Customer Billing and Payments	111,754	439,050
Software Consulting	54,573	399,822
Communication Systems	19,956	222,188
2015-2017 Audit Fees and FERC Review	13,809	171,086
Stock Materials	1,720	348,809
Insurance	-	646,080
Software Maintenance	-	323,543
Transmission Poles	-	189,726

<u>Water Projects</u>	<u>Spent-to-Date</u>	<u>Remaining Commitment</u>
St. Bridget's Water Tower	\$732,959	\$482,853
SCADA Replacement	439,475	131,383
Engineering & Consulting	92,424	115,620
Well Pump Replacement	60,805	4,710
Well House Construction	40,475	24,525
Stock Materials	4,435	16,384
Grounds Maintenance	-	27,870

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 13: Subsequent Events

In August 2014, the Utility Board approved and in September 2014 the City Council approved rate schedules to be effective January 1, 2015, 2016 and 2017 for the Electric Utility. The general increase is 3.5%, 1.7% and 1.7% respectively.

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

On March 29, 2016, the Utility Board approved the terms of an agreement for a tax-exempt draw down loan facility with US Bank for up to \$25 million with a term of two years from the date of closing. The facility allows RPU to make monthly draws incurring interest expense at a variable rate of 70% of the One Month London Interbank Offered Rate (LIBOR) plus 38.0 basis points on the accumulated total. RPU will pay a facility fee of 28.0 basis points for the unused portion of the facility. The closing date for the arrangement will be on or before April 19, 2016. This debt will be used to fund the initial stages of construction of a new 49 mW generation facility known as the Westside Energy Station as well as any remaining expenditures on the CapX2020 Transmission Line in excess of the remaining proceeds from the 2013B bond issue. The new debt is secured by a pledge of and lien on the Net Revenues of the Electric System, subordinate to the Senior Electric Utility Revenue Bonds, both previously issued and any issued in the future.

On October 27, 2015, the Utility Board approved the purchase of Wärtsilä engines as part of the Westside Energy Station. 83% of the purchase price is denominated in Euro's. On February 18, 2016 the Electric Utility executed a foreign exchange forward contract to hedge the currency risk related to the engine purchase. Under the terms of the agreement, the Electric Utility will deliver US\$17,000,000 to the Swap Provider on March 1, 2017 in exchange for receiving 15,078,943 Euro's.

In preparing these financial statements, Rochester Public Utilities has evaluated events and transactions for potential recognition or disclosure through March 31, 2016, the date the financial statements were available to be issued.

REQUIRED SUPPLEMENTARY INFORMATION (unaudited)

As of and for the Year Ended December 31, 2015

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	Statutorily Required Contribution (a)	Contributions in Relation to the Statutorily Required Contribution (b)	Contribution Deficiency (Excess) (a-b)	Covered-Employee Payroll (d)	Contributions as a Percentage of Covered-Employee Payroll (b/d)
December 31, 2015	\$1,053,611	\$1,053,611	-	\$14,048,147	7.5%

*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	Statutorily Required Contribution (a)	Contributions in Relation to the Statutorily Required Contribution (b)	Contribution Deficiency (Excess) (a-b)	Covered-Employee Payroll (d)	Contributions as a Percentage of Covered-Employee Payroll (b/d)
December 31, 2015	\$125,932	\$125,932	-	\$1,679,093	7.5%

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

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

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

Fiscal Year Ending (for the Measurement Period)	City of Rochester's Proportion (Percentage) of Net Pension Liability (Asset)	RPU Electric Utility's Allocated Share (Amount) of the Net Pension Liability (Asset) (a)	RPU Electric Utility's Covered-Employee Payroll (b)	RPU Electric Utility's Allocated Share of the Net Pension Liability (Asset) as a Percentage of its Covered-Employee Payroll (a/b)	Plan Fiduciary Net Position as a Percentage of the Total Pension Liability
June 30, 2015	0.7410%	\$11,722,132	\$13,004,761	90.14%	78.19%

*This schedule is presented prospectively beginning with the fiscal year ended June 30, 2015.

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

Fiscal Year Ending (for the Measurement Period)	City of Rochester's Proportion (Percentage) of Net Pension Liability (Asset)	RPU Water Utility's Allocated Share (Amount) of the Net Pension Liability (Asset) (a)	RPU Water Utility's Covered-Employee Payroll (b)	RPU Water Utility's Allocated Share of the Net Pension Liability (Asset) as a Percentage of its Covered-Employee Payroll (a/b)	Plan Fiduciary Net Position as a Percentage of the Total Pension Liability
June 30, 2015	0.7410%	\$1,400,562	\$1,512,163	92.62%	78.19%

*This schedule is presented prospectively beginning with the fiscal year ended June 30, 2015.

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, 2015

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.

There were no changes in assumptions.

OPERATING AND FINANCIAL STATISTICS (unaudited)

ELECTRIC

	2015	2014	2013	2012	2011	2006 (ten years ago)
RETAIL CUSTOMERS:						
Residential	46,961	46,035	45,651	45,244	44,700	41,926
General Service	4,807	4,759	4,725	4,740	4,701	4,501
Industrial / Commercial	2	2	2	2	2	2
Other	4	4	4	4	4	4
Total Retail Customers	51,774	50,800	50,382	49,990	49,407	46,433
RETAIL SALES: (mWh)						
Residential	335,708	341,452	348,952	342,986	346,088	333,685
General Service	644,067	637,360	641,210	634,692	642,712	623,562
Industrial / Commercial	205,164	212,297	225,082	236,566	236,880	292,580
Other	14,453	15,252	15,442	16,199	15,525	16,888
Total Retail Sales (mWh)	1,199,392	1,206,361	1,230,686	1,230,443	1,241,205	1,266,716
RETAIL REVENUE:						
Residential	\$44,025,807	\$42,818,865	\$42,344,833	\$41,924,195	\$42,565,163	\$33,537,874
General Service	66,051,022	63,734,518	62,342,255	62,452,007	62,924,479	49,559,854
Industrial / Commercial	18,227,249	18,277,321	18,562,734	19,405,820	19,455,536	17,183,144
Other	5,256,388	5,617,573	5,614,439	5,698,237	5,752,823	2,088,066
Total Retail Revenue	\$133,560,465	\$130,448,277	\$128,864,261	\$129,480,259	\$130,698,001	\$102,368,938
Steam Sales (MLBs)	441,791	424,402	451,945	447,579	459,491	165,676
Steam Revenues	\$5,412,228	\$6,743,606	\$4,849,550	\$5,427,419	\$5,512,332	\$2,617,899
Annual Peak (Megawatts)	262.0	258.7	278.6	287.8	292.1	288.3
Total mWh Generated	47,384	20,770	75,775	38,210	25,375	304,571
Total mWh Purchased	1,226,956	1,237,135	1,255,701	1,273,851	1,263,798	1,287,672
Year End Restricted/ Unrestricted Cash & Investment Balance	\$51,201,139	\$60,598,748	\$76,101,705	\$45,760,328	\$45,025,194	\$22,477,464

WATER

	2015	2014	2013	2012	2011	2006 (ten years ago)
RETAIL CUSTOMERS:						
Residential	35,332	34,871	34,571	34,213	33,827	32,143
Industrial / Commercial	3,501	3,459	3,463	3,454	3,442	3,384
Total Retail Customers	38,833	38,330	38,034	37,667	37,269	35,527
RETAIL SALES: (ccf)						
Residential	2,675,696	2,792,307	2,863,062	3,170,446	2,931,422	3,176,005
Industrial / Commercial	2,763,972	2,689,861	2,797,590	2,949,060	2,893,886	3,081,764
Total Retail Sales (ccf)	5,439,668	5,482,168	5,660,652	6,119,506	5,825,308	6,257,769
RETAIL REVENUE:						
Residential	\$4,385,870	\$4,283,618	\$4,286,290	\$4,526,267	\$4,290,475	\$4,017,533
Industrial / Commercial	2,258,383	2,118,160	2,684,057	2,808,702	2,741,479	1,962,485
Public Fire Protection	1,144,027	1,101,030	558,113	555,154	549,014	1,176,212
Total Retail Revenue	\$7,788,280	\$7,502,808	\$7,528,460	\$7,890,123	\$7,580,968	\$7,156,230
Total Pumped (billion gallons)	4.3	4.4	4.5	4.8	4.5	5.1
Year End Restricted/ Unrestricted Cash & Investment Balance	\$4,918,129	\$5,747,264	\$6,569,559	\$7,959,122	\$6,536,257	\$3,330,428



LEADERSHIP

(pictured from left to right)

Bill Cook • Director of Field Services

Sidney Jackson • Director of Core Services

Mark Kotschevar • General Manager

Peter Hogan • Director of Corporate Services

Walter Schlink • Director of Power Resources/Customer Relations



UTILITY BOARD

(front row left to right)

Dave Reichert • Board Member • Project Manager, Facilities Engineering Manager, IBM

Michael Wojcik • Board Member & City Council Liaison • Owner, Elite Consulting, Inc.

Mark Browning • Board Member • Project Manager, Facilities Project Services, Mayo Clinic

(back row left to right)

Roger Stahl • Board Member • Owner and Attorney, RMS Law Firm, PLLC

Jerry Williams • Board President • Retired

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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