

Determined to *Deliver*



2010 FINANCIAL STATEMENTS



Management Discussion & Analysis

The following discussion and analysis of the financial results of Rochester Public Utilities (RPU or the Utility) provides an overview of the utility's financial activities for the year ended December 31, 2010. This discussion is designed to be used in conjunction with the financial statements and notes, which follow this section.

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

Overview of the Financial Statements

Consolidated Financial Statements

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

Notes to Consolidated Financial Statements

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

HIGHLIGHTS

- Despite national economic conditions, Rochester continued to grow with 544 new electric customers and 219 new water customers being added in 2010. Growth for the Electric Utility doubled from 2009, with part of this growth coming from acquisition of service territory and customers from People's Coop. However, growth for the Water Utility was lower than the recent past.
- The warmer summer weather had a small positive impact on revenues and demand increased as well due to the warmer weather patterns. Retail kilowatt-hour sales increased 1.9% over 2009. The annual peak demand of 278.3 megawatts was set in August, which is an increase of 6.6% over the demand of 261.0 megawatts set in June 2009. The record demand of 288.3 megawatts was set in July 2006.
- Retail water sales (ccf) were down 4.6% in 2010 due in part to higher-than-average rainfall.
- Due to cost reduction measures implemented in 2009 and 2010, there were no rate increases for either the Electric or Water Utility for 2010.
- Rates for power purchased from SMMPA (Southern Minnesota Municipal Power Agency) increased 4% in January 2010. Purchased power costs from SMMPA and the MISO market represented 69% of electric operating expenses for 2010.
- The Electric Utility transferred approximately \$8.4 million, and the Water Utility transferred \$340,000 to the City of Rochester's General Fund in the form of in-lieu-of-tax payments.

- As a result of the cost-of-service/rate design study completed for the Water Utility in 2009, Utility staff designed and implemented a new rate structure, effective April 1, 2010 that includes water conservation rates for residential customers and commercial irrigation customers. Conservation rates are required by Minnesota Statute.
- In December 2010, the Electric Utility made the final payment on the 2000A Revenue Bonds. The remaining 2011-2030 maturities were also paid off with funds from the trust account that was set up when the bonds were refunded in advance in 2007. This triggered the release of \$2.5 million from the debt service reserve account into unrestricted cash for the electric utility.
- In December 2010, the Water Utility made the final payment on the 2006 Revenue Note, leaving the Water Utility with no debt outstanding at the end of 2010.
- RPU continues to sell energy from the Silver Lake Plant and the Cascade Creek gas turbine into the MISO (Midwest Independent System Operators) market, as well as purchase power through the MISO market for all power needs above the Contract Rate of Delivery limit of 216 megawatts provided by SMMPA.
- RPU continues to be involved in the CapX 2020 project. Specifically, RPU is involved with four other utilities, Xcel Energy, Dairyland Power Cooperative, SMMPA, and Wisconsin Public Power Inc., in the future construction of a 345-kilovolt transmission line coming from the Twin Cities down to Rochester, and over to LaCrosse.
- RPU surpassed its Aggressive Demand-Side Management (DSM) goal for 2010 of 19,100 megawatt hours in energy savings. Actual energy savings of 19,126 megawatt hours were achieved through helping commercial and residential customers install energy efficient equipment and technologies. This represents an estimated 19,126 tons of carbon reduction.
- Legislative changes in 2007 affecting the Utility included the Next Generation Energy Act of 2007. To that end, an energy savings goal of 1.5% of annual retail energy sales was set for all Minnesota utilities to reach by 2010. For 2010, RPU's energy savings of 19,126 megawatt hours represented 1.5% of annual retail energy sales.

Financial Analysis – Electric Utility

The following discussion provides analysis of the 2010 and 2009 comparative financial information provided in the following table.

Condensed Financial Information - Electric Utility

December 31, 2010 and 2009

(In millions)

Statement of Revenues, Expenses, & Changes in Net Assets

	2010	2009	Change
Operating Revenues	\$ 142.8	\$ 136.1	\$ 6.7
Operating Expenses	127.9	120.3	7.6
<i>Operating Income</i>	<u>14.9</u>	<u>15.8</u>	<u>(0.9)</u>

Transfers Out

(In-Lieu-Of-Tax Payments)	(8.4)	(8.2)	(0.2)
Other Income & Expense	0.4	0.3	0.1
Interest Expense	(4.2)	(4.1)	(0.1)
Nonoperating Revenue (Expense)	(12.2)	(12.0)	(0.2)
<i>Change in Net Assets</i>	<u>2.7</u>	<u>3.8</u>	<u>(1.1)</u>

Net Assets - Beginning of Year	144.9	141.1	3.8
Net Assets - End of Year	\$ 147.6	\$ 144.9	\$ 2.7

Statement of Net Assets

	2010	2009	Change
Cash and Investments	\$ 42.3	\$ 37.9	\$ 4.4
Other Current Assets	19.3	26.5	(7.2)
Capital Assets, Net	188.8	185.7	3.1
Other Noncurrent Assets	3.8	6.4	(2.6)
<i>Total Assets</i>	<u>254.2</u>	<u>256.5</u>	<u>(2.3)</u>
Current Liabilities	17.6	18.7	(1.1)
Long-Term Debt	86.9	90.8	(3.9)
Other Long-Term Liabilities	2.1	2.1	-
<i>Total Liabilities</i>	<u>106.6</u>	<u>111.6</u>	<u>(5.0)</u>

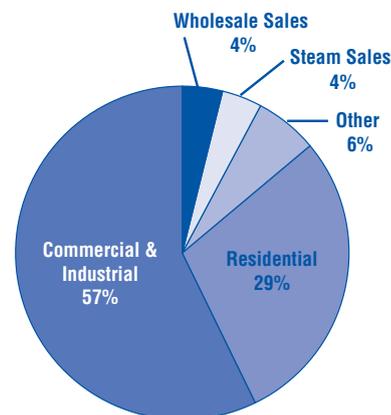
Invested in Capital Assets,

Net of Related Debt	100.6	96.1	4.5
Restricted	2.5	8.6	(6.1)
Unrestricted	44.5	40.2	4.3
Net Assets	\$ 147.6	\$ 144.9	\$ 2.7

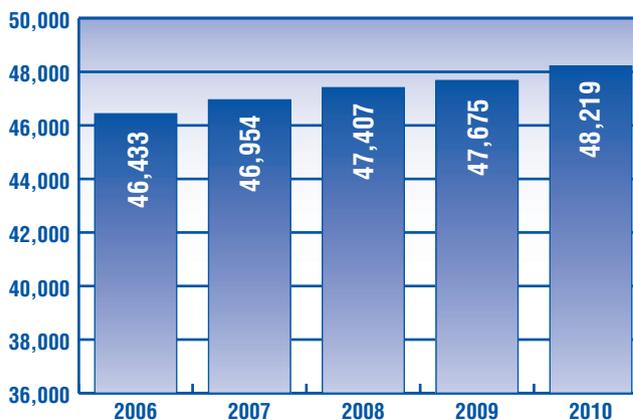
Operating Revenues

Operating revenues increased \$6.7 million (4.9%) in 2010. This was due to an increase in retail kilowatt-hour sales of 1.9% and an increase in wholesale revenues of 19.3%.

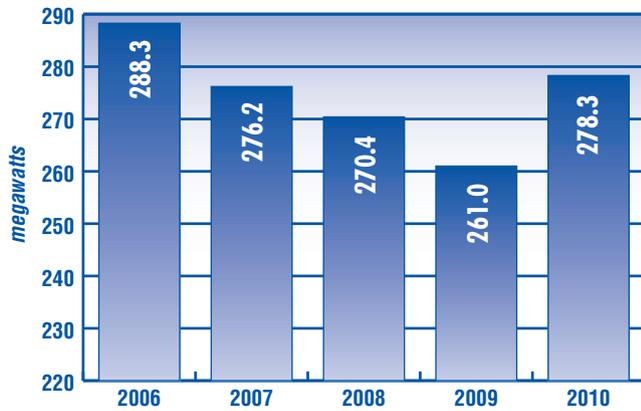
Electric Operating Revenues



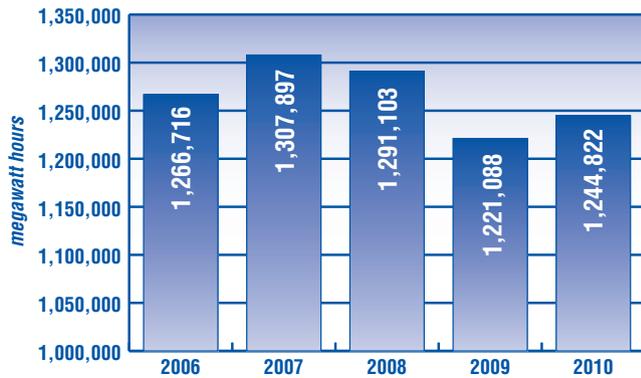
Number of Electric Customers



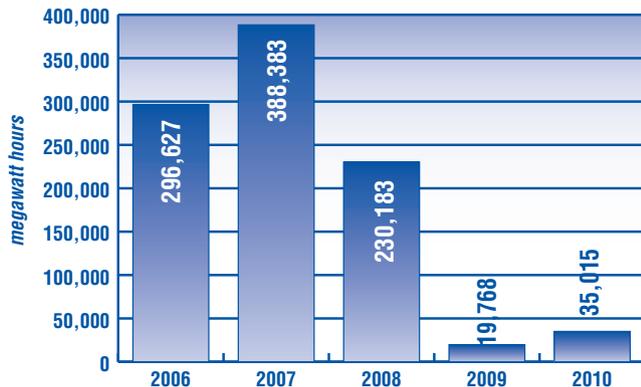
Electric Peaks



Electric Retail Sales



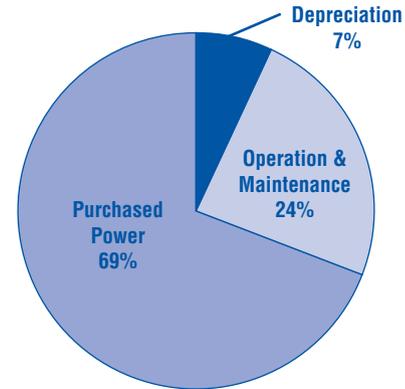
Wholesale Sales



Operating Expenses

Operating expenses increased \$7.6 million (6.3%) in 2010, due primarily to an increase in generation fuel costs and purchased power. The primary driver of operating expenses for the Electric Utility continues to be purchases of power from SMMPA and from the MISO market, which comprised 69% of total operating expenses.

Electric Operating Expenses



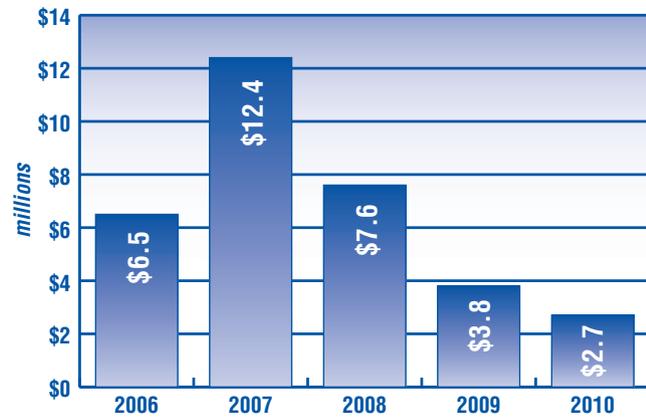
In-Lieu-of-Tax Payments

The Electric Utility transfers an amount to the City of Rochester's General Fund each month based on the amount of retail kilowatt-hours sold. Due to an increase in kilowatt-hour sales the payment to the City increased by \$160,000.

Change in Net Assets

The increase in net assets for 2010 was \$2.7 million, \$1.1 million (28.9%) less than in 2009. This is primarily due to an increase in retail kilowatt-hour sales and wholesale revenues, offset by a larger increase in purchased power and generation fuel.

Change in Net Assets

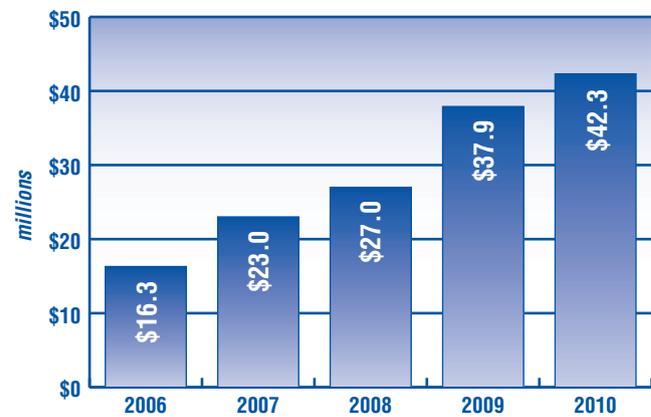


Cash, Investments and Other Assets

The ending unrestricted cash and investments balance for 2010 was \$42.3 million, \$4.4 million higher than 2009. This is primarily due to the reimbursement of capital expenditures from the 2009 note issue proceeds.

In 2005, the Utility Board revised the Financial Liquidity policy to address business risks and better position RPU for the future. Four cash reserve components were established along with guidelines for the calculation of cash reserve targets. Each year as the budget is finalized, revised projections are made for the subsequent four years, and new cash reserve targets are developed based on the board-policy guidelines. It was management's goal that actual cash reserves be at 100% of the board-policy cash reserve target by the end of 2010, which was achieved.

Unrestricted Cash and Investments – Electric



Other current assets for 2010 were \$19.3 million, \$7.2 million lower than at the end of 2009. This decrease was due primarily to a decrease in fuels inventory. Although wholesale sales increased in 2010, they are still significantly less than in previous years due to the depressed wholesale market. With reduced sales, RPU was able to draw down its coal inventory for energy sales into the wholesale market without making additional coal purchases. Additionally, \$3.6 million of proceeds from the revenue note issued in September 2009, classified as restricted cash, were fully drawn down in 2010. These funds were used for transmission and substation related projects.

Other noncurrent assets decreased by \$2.6 million in 2010. With the Series 2000A revenue bonds being paid in full in December 2010, \$2.5 million that was held in reserve for this bond issue was released from restricted cash.

Liabilities

Current liabilities decreased \$1.1 million in 2010, primarily due to a decrease in accounts payable which included a significant balance due for the repair of a gas turbine in 2009.

Net Assets

Net assets invested in capital assets, net of related debt, increased \$4.5 million. This increase reflects additions to capital assets funded through rate-based revenues, fees from customers, and debt proceeds.

Restricted net assets decreased by \$6.1 million. This represents resources that are subject to external restrictions, such as bond covenants or third-party contractual agreements. Specifically, restricted net assets for the Electric Utility consist of cash restricted for bonded projects. See Note 4 to the financial statements for additional details regarding this amount.

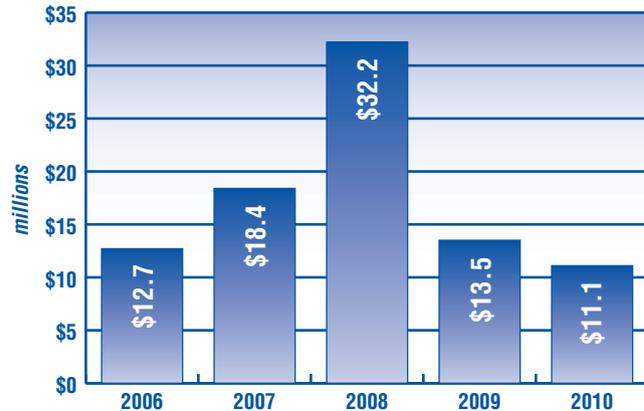
Unrestricted net assets are not subject to any constraints by debt covenants or other legal requirements. In 2010, unrestricted net assets increased \$4.3 million due to the results of operations.

CAPITAL ASSETS

At December 31, 2010, the Electric Utility had \$188.8 million invested in a broad range of utility capital assets, including a coal-burning steam generation plant, two gas turbines, a hydroelectric power generation plant, two diesel generators, equipment related to providing Mayo Clinic's Prospect Plant with steam, emission reduction equipment, electric transmission and distribution lines, buildings and equipment. Capital assets increased \$11.7 million in 2010, reflecting investments in the distribution and transmission

systems, and general facilities of the Electric Utility. This increase in capital assets was partially offset by a \$8.6 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 and major maintenance expenses decreased by \$2.3 million in 2010, due to less development activity and cost controls.

Capital and Major Maintenance Expenditures



LONG-TERM DEBT

At the end of 2010, the Utility had \$81.7 million in revenue bonds and \$8.4 million in revenue notes outstanding. No new debt was issued during the year and \$3.6 million was retired in 2010.

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

Financial Analysis – Water Utility

The following discussion provides analysis of the 2010 and 2009 comparative financial information provided in the following table.

Condensed Financial Information - Water Utility

December 31, 2010 and 2009

(In millions)

Statement of Revenues, Expenses, & Changes in Net Assets

	2010	2009	Change
Operating Revenues	\$ 8.1	\$ 8.2	\$ (0.1)
Operating Expenses	7.3	7.2	0.1
<i>Operating Income</i>	<u>0.8</u>	<u>1.0</u>	<u>(0.2)</u>
Transfers Out			
(In-Lieu-Of-Tax Payments)	(0.3)	(0.4)	0.1
Other Income & Expense	0.1	–	0.1
Interest Expense	–	–	–
Capital Contributions	2.9	2.6	0.3
Nonoperating Revenue (Expense)	2.7	2.2	0.5
<i>Change in Net Assets</i>	<u>3.5</u>	<u>3.2</u>	<u>0.3</u>
Net Assets - Beginning of Year	88.0	84.8	3.2
<i>Net Assets - End of Year</i>	<u>\$ 91.5</u>	<u>\$ 88.0</u>	<u>\$ 3.5</u>

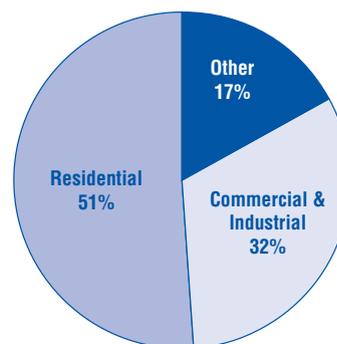
Statement of Net Assets

	2010	2009	Change
Cash and Investments	\$ 6.9	\$ 5.9	\$ 1.0
Other Current Assets	0.4	0.5	(0.1)
Capital Assets, Net	85.8	83.1	2.7
<i>Total Assets</i>	<u>93.1</u>	<u>89.5</u>	<u>3.6</u>
Current Liabilities	1.4	1.3	0.1
Long-Term Debt	–	–	–
Other Long-Term Liabilities	0.2	0.2	–
<i>Total Liabilities</i>	<u>1.6</u>	<u>1.5</u>	<u>0.1</u>
Invested in Capital Assets, Net of Related Debt	85.8	82.6	3.2
Unrestricted	5.7	5.4	0.3
<i>Net Assets</i>	<u>\$ 91.5</u>	<u>\$ 88.0</u>	<u>\$ 3.5</u>

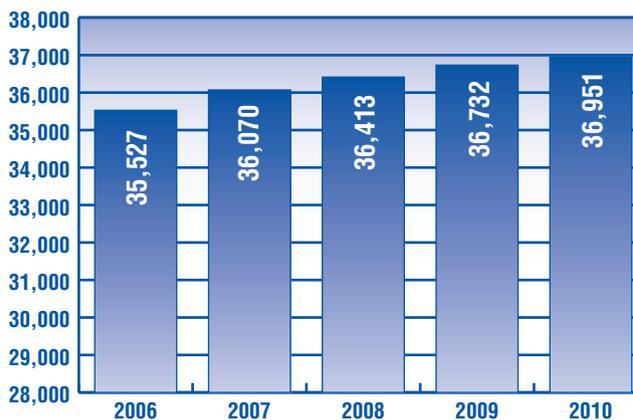
Operating Revenues

Operating revenues decreased by \$60,000 (1.2%) in 2010. Rates from 2009 were not changed. Sales volume decreased by 4.6%, however, utility service revenues decreased by only 0.5%. This is due to the rate structure where approximately 45% of utility service revenue comes from a fixed customer charge that doesn't vary with sales volume. In addition to the reduction in revenue related to sales volume, other operating revenue also decreased by 23,000 (3%).

Water Operating Revenues



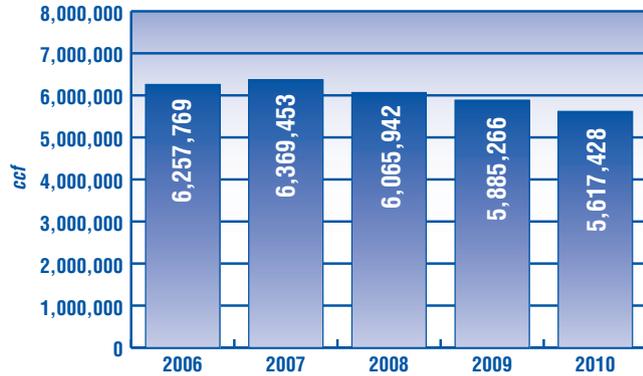
Number of Water Customers



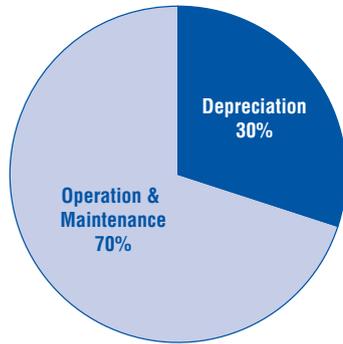
Operating Expenses

Operating expenses increased by \$70,000 (1.0%) in 2010. This was primarily due to increases in salaries expense and depreciation.

Water Retail Sales



Water Operating Expenses



In-Lieu-of-Tax Payments

The Water Utility transfers an amount to the City of Rochester’s General Fund each month based on the amount of retail ccf (hundred cubic feet) sold. Due to the decrease in ccf sold in 2010, payments to the City decreased by approximately \$17,000.

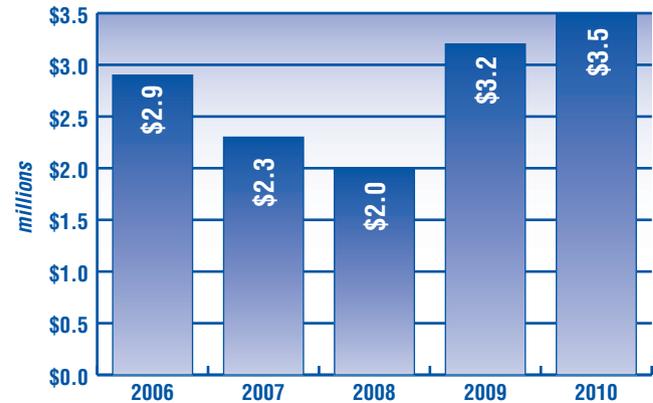
Capital Contributions

Capital contributions increased \$0.3 million in 2010. These are assets, primarily water towers, water mains, and fire hydrants, which are contributed to the Water Utility from both the City and developers. These assets are valued using a costing database that estimates the approximate construction costs associated with these assets.

Change in Net Assets

The increase in net assets for 2010 was \$3.5 million, \$0.3 million higher than in 2009. This is primarily due to the increase in reported capital contributions in 2010.

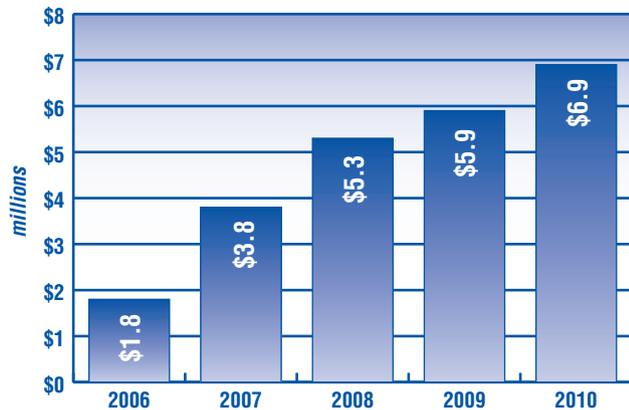
Change in Net Assets



Cash, Investments and Other Assets

The ending unrestricted cash and investments balance for 2010 was \$6.9 million, \$1.0 million higher than 2009 due to lower than anticipated capital expenditures.

Unrestricted Cash and Investments – Water



Other current assets decreased by \$80,000 in 2010, due primarily to a decrease in accounts receivable.

Liabilities

Current liabilities increased \$160,000 in 2010 due to a much larger amount owed to the City at the end of 2010, offset by a decrease in the current portion of long-term debt due to the 2006 Revenue Note being paid off in 2010.

Net Assets

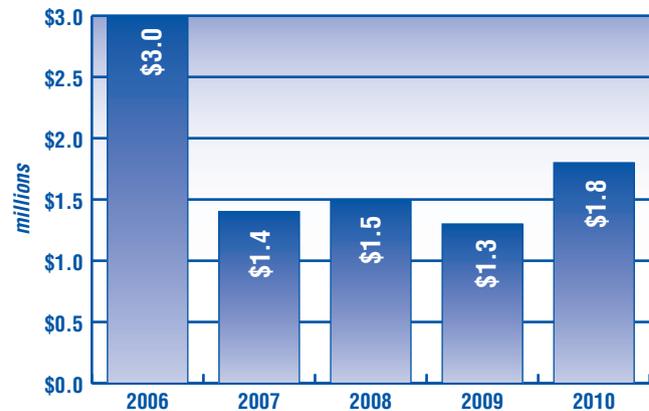
Net assets invested in capital assets, net of related debt, increased \$3.2 million. This increase reflects additions to capital assets. Capital expenditures for the Water Utility are funded through rate-based revenues, fees from customers and debt proceeds.

Unrestricted net assets are not subject to any constraints established by debt covenants or other legal requirements. In 2010, unrestricted net assets increased \$0.3 million due to the results of operations.

CAPITAL ASSETS

At December 31, 2010, the Water Utility had \$85.8 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 \$4.8 million in 2010, 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 \$2.1 million increase in accumulated depreciation. Additional details regarding the Utility's total assets (electric and water) may be found in Note 5 to the financial statements. Capital and major maintenance expenses increased by \$450,000 in 2010, due to some larger projects and more work being completed in 2010. Some of the major components of capital spending in 2010 were City and developer projects, new wells, water storage facility maintenance, well maintenance and spending on water meters and automated meter reading.

Capital and Major Maintenance Expenditures



LONG-TERM DEBT

At the end of 2010, the Utility had no debt outstanding. No new debt was issued during the year, and \$410,000 was retired in 2010.

Miscellaneous Information

ECONOMIC FACTORS

The City Council has approved Electric and Water rate increases as needed to support the utility on a cost of service basis. In December 2009, the Utility Board voted to have no rate increase for 2010 for both the Electric and Water Utilities. The Electric Utility has had rate increases for five consecutive years through 2009. The Water Utility has had 5.0% increases each year in 2005, 2006 and 2007. These prior year increases, along with aggressive cost control measures positioned RPU to have no rate increase in 2010 to support the Rochester community during difficult economic conditions. 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

Year	Inflation	Electric Rates	Water Rates
2011*	2.5%	0.0%	0.0%
2010*	1.8%	0.0%	0.0%
2009	(0.4%)	5.0%	0.0%
2008	3.9%	4.0%	0.0%
2007	2.8%	8.0%	5.0%
Annualized Average	2.1%	3.4%	1.0%

*Estimated Yearly Values

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

With the continued slowdown in the housing market, growth of the city has remained slow as well. In 2010, there were 200 building permits totaling \$41.4 million issued for single-family homes as compared to 256 permits totaling \$46.8 million in 2009. Commercial building permits increased, however, numbering 41 for 2010 totaling \$52.3 million as compared to 30 commercial permits valued at \$28.2 million in 2009.

The December 2010 unemployment rate of 5.5% for the area remains well below the state and national rates of 6.8% and 9.1%, 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 5.8%.

After examining all of these factors in the budgeting process, RPU has projected electric rates to increase modestly over the next five years, while water rates are expected to remain steady. However, taking into account the current economic conditions and the effect it has had on customers, management has felt it prudent to avoid an electric rate increase for 2011 as it did in 2010. RPU management and employees were able to make this possible by continuing to hold costs at 2009 and 2010 levels.

REQUESTS FOR INFORMATION

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

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

	Years Ended December 31	
	2010	2009
Operating Revenues:		
Electric:		
Retail	\$127,980,879	\$123,093,014
Wholesale	5,376,520	4,507,199
Other	9,411,056	8,549,225
Water	8,132,956	8,192,390
Total Operating Revenues	150,901,411	144,341,828
Operating Expenses:		
Purchased Power	88,157,635	81,138,926
Operations and Maintenance	35,770,208	36,075,061
Depreciation	11,233,005	10,331,042
Total Operating Expenses	135,160,848	127,545,029
Operating Income	15,740,563	16,796,799
Nonoperating Income (Expenses):		
Investment Income	962,687	1,102,545
Interest Expense	(4,194,967)	(4,073,070)
Miscellaneous, Net	(509,808)	(789,030)
Total Nonoperating Income (Expenses)	(3,742,088)	(3,759,555)
Income Before Transfers/Capital Contributions	11,998,475	13,037,244
Transfers Out	(8,745,642)	(8,601,990)
Capital Contributions	2,909,926	2,595,007
Change in Net Assets	6,162,759	7,030,261
Net Assets, Beginning of Year	232,989,611	225,959,350
Net Assets, End of Year	\$239,152,370	\$232,989,611

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

Income by Segments of Business

2010	Electric	Water	Total
Operating Revenues:			
Retail	\$127,980,879	\$7,388,463	\$135,369,342
Wholesale	5,376,520	–	5,376,520
Other	9,411,056	744,493	10,155,549
Total Operating Revenues	142,768,455	8,132,956	150,901,411
Operating Expenses	127,900,736	7,260,112	135,160,848
Operating Income	14,867,719	872,844	15,740,563
Nonoperating Income (Expense)	(3,795,130)	53,042	(3,742,088)
Income Before Transfers/Capital Contributions	11,072,589	925,886	11,998,475
Transfers Out	(8,402,549)	(343,093)	(8,745,642)
Capital Contributions	–	2,909,926	2,909,926
Change in Net Assets	\$2,670,040	\$3,492,719	\$6,162,759

2009	Electric	Water	Total
Operating Revenues:			
Retail	\$123,093,014	\$7,424,541	\$130,517,555
Wholesale	4,507,199	–	4,507,199
Other	8,549,225	767,849	9,317,074
Total Operating Revenues	136,149,438	8,192,390	144,341,828
Operating Expenses	120,356,118	7,188,911	127,545,029
Operating Income	15,793,320	1,003,479	16,796,799
Nonoperating Income (Expense)	(3,761,411)	1,856	(3,759,555)
Income Before Transfers/Capital Contributions	12,031,909	1,005,335	13,037,244
Transfers Out	(8,242,341)	(359,649)	(8,601,990)
Capital Contributions	–	2,595,007	2,595,007
Change in Net Assets	\$3,789,568	\$3,240,693	\$7,030,261

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

Consolidated Statements of Net Assets

	December 31	
	2010	2009
ASSETS:		
Current Assets:		
Cash and Cash Equivalents (Note 3)	\$6,860,969	\$9,336,817
Investments	42,373,881	34,480,414
Accounts Receivable and Accrued Utility Revenues	11,514,807	11,429,192
Fossil Fuel Inventory	2,776,077	6,568,850
Materials and Supplies Inventory	5,308,314	5,208,667
Restricted Cash and Cash Equivalents (Note 4)	–	3,651,298
Other Current Assets	74,701	180,726
Total Current Assets	68,908,749	70,855,964
Non-Current Assets:		
Restricted Assets (Note 4):		
Investments	2,499,927	4,966,628
Deferred Charges:		
Unamortized Bond Issuance Costs	705,515	807,539
Other	591,697	590,095
Total Deferred Charges	1,297,212	1,397,634
Capital Assets:		
Construction Work in Progress	20,864,999	21,697,174
Land and Land Rights	3,415,683	3,220,729
Depreciable Assets, Net (Note 5):		
Electric	170,896,940	167,000,694
Water	79,514,291	76,946,857
Net Capital Assets	274,691,913	268,865,454
Total Non-Current Assets	278,489,052	275,229,716
Total Assets	\$347,397,801	\$346,085,680

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

	December 31	
	2010	2009
LIABILITIES:		
Current Liabilities:		
Accounts Payable	\$9,398,966	\$10,443,091
Due to Other Funds	2,340,551	1,666,813
Accrued Compensation and Compensated Absences	2,362,355	2,252,398
Customer Deposits	493,010	453,957
Interest Payable	309,390	316,813
Current Maturities of Long Term Debt (Note 6)	3,824,362	4,268,252
Deferred Credits	258,158	603,751
Total Current Liabilities	18,986,792	20,005,075
Non-Current Liabilities:		
Accrued Compensated Absences	1,588,963	1,530,771
Accrued Claims	40,000	49,000
Long-Term Debt (Note 6)	86,927,882	90,773,008
Unearned Lease Revenues	701,795	738,215
Total Non-Current Liabilities	89,258,640	93,090,994
Commitments and Contingencies (Note 10)		
Total Liabilities	\$108,245,432	\$113,096,069
NET ASSETS:		
Invested in Capital Assets, Net of Related Debt	\$186,439,596	\$178,790,823
Restricted for Construction (Note 4)	-	3,651,298
Unrestricted Net Assets	52,712,774	50,547,490
Total Net Assets	\$239,152,370	\$232,989,611

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

Consolidated Statements of Cash Flows

	Years Ended December 31	
	2010	2009
Cash Flows From Operating Activities:		
Cash Received from Customers	\$145,597,441	\$140,386,871
Cash Paid to Suppliers and Employees	(123,332,807)	(111,805,352)
Internal Activity – Payments From Other Funds	5,415,582	5,197,110
Net Cash Provided By Operating Activities	27,680,216	33,778,629
Cash Flows From Noncapital Financing Activities:		
Operating Transfers to Other Funds	(8,724,434)	(8,619,111)
Cash Flows From Capital and Related Financing Activities:		
Additions to Utility Plant and Other Assets	(11,637,198)	(17,700,992)
Service Territory Acquisition	(948,198)	(1,275,192)
Payments on Bonds and Notes Payable Obligations	(8,423,149)	(7,261,442)
Proceeds from Issuance of Notes Payable	–	6,790,000
Net Cash (Used In) Capital and Related Financing Activities	(21,008,545)	(19,447,626)
Cash Flows From Investing Activities:		
Interest Received	1,352,383	1,125,784
Increase in Investments	(5,426,766)	(35,166,310)
Net Cash (Used In) Investing Activities	(4,074,383)	(34,040,526)
Net Increase (Decrease) in Cash and Cash Equivalents	(6,127,146)	(28,328,634)
Cash and Cash Equivalents, Beginning of Year	12,988,115	41,316,749
Cash and Cash Equivalents, End of Year	6,860,969	12,988,115
Classified As:		
Current Assets	\$6,860,969	\$9,336,817
Restricted Assets	–	3,651,298
Total Cash and Cash Equivalents, End of Year	\$6,860,969	\$12,988,115
Reconciliation of Operating Income to Net Cash Provided by Operating Activities:		
Operating Income	\$15,740,563	\$16,796,799
Adjustments to Reconcile Operating Income to Net Cash Provided by Operating Activities:		
Depreciation	11,233,005	10,331,042
Bad Debts	123,930	478,228
Other	(476,013)	(740,886)
(Increase) Decrease In:		
Accounts Receivable and Accrued Utility Revenues	(209,546)	(604,415)
Inventories	3,693,126	4,180,812
Prepaid and Other Current Assets	92,963	43,778
Increase (Decrease) In:		
Accrued Liabilities and Accounts Payable	(2,174,852)	2,875,620
Customer Deposits	39,053	106,141
Unearned Lease Revenues	(36,420)	(36,420)
Other	(345,593)	347,930
Net Cash Provided by Operating Activities	\$27,680,216	\$33,778,629
Non-Cash Capital and Related Financing Activities:		
Additions to Utility Plant and Other Assets Contributed By:		
City's Governmental Funds	\$2,831,933	\$2,452,751
Developers	\$77,993	\$142,256
Equipment Purchases in Accounts Payable	\$2,472,143	\$907,928

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

Notes to Consolidated Financial Statements

NOTE 1: Organization and Summary of Significant Accounting Policies

Organization and Accounting Method

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

Operating Revenues

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

Accounts Receivable

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

Capital Assets, Depreciation and Amortization

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

Contributions in Lieu of Taxes

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

Inventories

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

Compensated Absence Benefits

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

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

Amortization of Bond Issuance Costs and Bond Discount/Premium

Bond issuance costs, bond discounts and bond premiums are amortized over the terms of the related bond issues using the interest method.

Taxes

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

Use of Estimates

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

Reclassifications

Certain reclassifications have been made to the 2009 financial statements to conform to the 2010 presentation.

Concentration of Credit Risk

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

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

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

NOTE 2: Revenues

Revenue, consisting primarily of billings to customers for Utility services, includes accrued Utility revenue amounts of \$3,883,101 and \$3,574,482 for the years ended December 31, 2010 and 2009, respectively.

Sales to the Utilities single largest customer were \$21,731,988 (\$16,176,619 retail and \$5,555,369 other) and \$20,895,545 (\$15,717,401 retail and \$5,178,144 other) in 2010 and 2009, respectively. During the year ended December 31, 2010, no other customer accounted for more than 10% of operating revenues. Sales to other funds of the City of Rochester were \$4,871,890 and \$4,945,851 for the years ended December 31, 2010 and 2009, respectively.

NOTE 3: Cash and Cash Equivalents

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

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

The Utility's equity in the City of Rochester cash and investment pool is based on actual cash receipts and disbursements and a monthly allocation of investment earnings on a pro-rata basis. Investments held in the investment pool are disclosed in the notes to the City of Rochester's basic financial statements included in the City's 2010 Comprehensive Annual Financial Report.

NOTE 4: Restricted Assets

Under the provisions of the 2000A and 2002A revenue bonds, the Electric Utility is required to fund a debt service account in an amount equal to the following year's bond principal and interest payments at least by the date the debt service payments are due each year. In addition to the debt service account, bond provisions require that \$2,499,927 of the bond proceeds be deposited in a reserve account to be used to pay bond principal and interest payments if funds in the debt service account are insufficient. Under the provisions of the bond agreements and a revenue note, unspent proceeds are placed in a construction fund until capital expenditures are made.

Restricted Assets are summarized as follows:

	2010	2009
Reserve Account – Investments	\$ 2,499,927	\$ 4,966,628
Construction Fund – Cash and Cash Equivalents	–	3,651,298
Total Restricted Assets	\$ 2,499,927	\$ 8,617,926

NOTE 5: Capital Assets

Major classes of depreciable assets and total accumulated depreciation as of December 31, 2010 and 2009 are as follows:

	2010	2009
Intangible Plant Assets	\$ 11,715,783	\$ 10,763,107
Buildings, Structures, and Improvements	44,069,725	43,481,508
Installations, Equipment, and Fixtures	342,750,549	327,092,905
Total Depreciable Assets	398,536,057	381,337,520
Less: Accumulated Depreciation	148,124,826	137,389,969
Net Depreciable Assets	\$ 250,411,231	\$ 243,947,551

In 2010, capital assets totaling \$2,831,933 were contributed to the Utility by other funds of the City of Rochester, and \$77,993 were contributed to the Utility by others.

NOTE 6: Long-Term Debt

At December 31, 2010 and 2009, long-term debt consisted of the following:

	2010	2009
Revenue Bonds, Series 2007C 4.00% - 5.00%, due each December 1 through 2030	\$ 75,515,000	\$ 75,750,000
Revenue Bonds, Series 2002A 3.00% - 4.50%, due each December 1 through 2017	6,170,000	6,910,000
Revenue Bonds, Series 2000A, 4.75% - 5.25%, due each December 1 through 2010	–	865,000
Revenue Note Payable, principal due each December 1 through 2014, interest at variable rate, currently 0.33%, ongoing line of credit fees and administrative fees due each June 1 and December 1	3,035,000	3,615,000
Revenue Note Payable 3.80%, principal due each December 1 through 2010, interest due monthly	–	410,000
Revenue Note Payable, principal due each December 1 through 2014, interest at variable rate, currently 0.33%, ongoing line of credit fees and administrative fees due each June 1 and December 1	5,380,000	6,590,000
Capital lease obligations	16,867	228,252
Less: Unamortized Discount	172,910	185,427
Less: Unamortized Deferred Amount on Refunding	1,651,850	1,788,870
Plus: Unamortized Premium	2,460,137	2,647,305
Less: Current Maturities	3,824,362	4,268,252
Total Long-Term Debt	\$ 86,927,882	\$ 90,773,008

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

In March 2007, the Electric Utility issued \$76.2 million in Revenue Bonds, Series 2007C, to finance the emission reduction project at Silver Lake Plant, transmission and substation work, and distribution system expansion, and to advance refund the majority of the outstanding Series 2000A Bonds. With respect to the refunded portion, net proceeds of \$31.7 million (after payment of underwriting fees, insurance, and other issuance costs) were deposited in an irrevocable trust with an escrow agent to provide for all future debt service payments on the refunded portion of the Series 2000A Bonds. In December 2010 the Series 2000A Bonds were paid in full and the escrow agent released all funds, including the \$2,471,688 debt service reserve.

This advance refunding resulted in a difference between the reacquisition price and net carrying amount of the old debt of \$2,172,658. This difference, reported in the financial statements as a deduction from revenue bonds payable, is being amortized and charged to operations over the bond term using the interest method. The unamortized balance at December 31, 2010 and 2009 was \$1,651,850 and \$1,788,870 respectively. The Utility completed the advance refunding to reduce its total debt service payments over the subsequent 23 years by \$3.1 million and to obtain an economic gain (difference between the present values of the old and the new debt service payments) of \$2.0 million.

The annual requirements to amortize all debt outstanding as of December 31, 2010, including interest payments of \$47,408,811 are as follows:

	Revenue Bonds	Notes Payable
2011	5,627,681	2,227,803
2012	5,631,081	2,281,350
2013	5,631,281	2,344,186
2014	5,633,281	2,402,135
2015	6,605,788	—
Thereafter	99,124,225	—
Total	\$ 128,253,337	\$ 9,255,474

NOTE 7: Southern Minnesota Municipal Power Agency

The Utility is a voting member of the Southern Minnesota Municipal Power Agency (SMMPA). The Utility has entered into a power purchase contract with SMMPA, whereby SMMPA will provide all Utility power requirements up to 216 megawatts, the contract rate of delivery. This contract expires in the year 2030. In 1999, the Utility and SMMPA agreed to a contract rate of delivery (CROD) that began in 2000. The CROD caps the amount of power SMMPA must supply to the Utility under the power purchase contract. The Utility is responsible for acquiring its power needs above the CROD. The Utility purchased 1,254,839,127 and 1,233,900,666 kilowatt hours totaling \$87,705,689 and \$80,715,232 from SMMPA during the years ended December 31, 2010 and 2009, respectively.

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

NOTE 8: Pension Plans

The Utility participates in a statewide retirement plan administered by the Public Employees Retirement Association (PERA) of Minnesota. PERA administers the General Employees Retirement Fund (GERF) which is a cost sharing, multiple employer retirement plan. PERA provides retirement benefits as well as disability benefits to members and benefits to survivors upon death of eligible members. Benefits and annual contributions are established by State statute. Total required contributions made during the year ended December 31, 2010 were \$1,895,299 of which \$1,019,247 was made by the Utility and \$876,052 was made by the Utility's employees.

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

The Utility had maintained an unqualified supplemental pension plan. The plan was unfunded and was discontinued in 1968. Funds have been deposited with a plan administrator to fund the estimated benefits due under the plan. The pension reserve deposit as of December 31, 2010 and 2009 was \$59,047 and \$66,181, respectively.

NOTE 9: Legal Matters

In 2005, the City of Rochester brought a claim against Southern Minnesota Municipal Power Agency (SMMPA) its primary wholesale power supplier, seeking a declaratory judgment over cost responsibility for new generating resources and alleging a breach of contract over SMMPA's rate setting methods. SMMPA filed counterclaims alleging a breach of the 1992 "Settlement Agreement" concerning the use of RPU's Silver Lake Plant, seeking declaratory judgments regarding issues relating to the nature of RPU's obligations under the Power Sales Contract and that the SMMPA Board has virtually unlimited discretion in setting rates under the Power Sales Contract with Rochester.

On May 8, 2009, the Court issued a decision that denied the City's requested declaratory judgment, granted portions of SMMPA's counterclaims concerning its rate setting authority but denied the remainder. The decision rejected SMMPA's counterclaim concerning the Settlement Agreement. On March 17, 2010, the Court issued a final order granting SMMPA's motion for payment of \$252,317 for expert witness fees. The date for possible appeals has passed and the Court's order for payment was carried out in 2010.

NOTE 10: Commitments and Contingencies

Risk Management Program

The City of Rochester has established a self-insurance program for group health coverage and workers' compensation. Rochester Public Utilities participates in this self-insurance program. The group health program is limited to losses of \$275,000 per claim with a variable annual aggregate, and the workers' compensation coverage is limited to \$900,000 per occurrence, both through the use of stop-loss policies. The City recognizes a liability on individual claims when a loss is probable and the amount can be reasonably estimated. In addition, the City recognizes an estimated liability on unreported claims that are incurred but not yet reported.

Power Sales Agreement

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

Revenue under these agreements for the years ended December 31, 2010 and 2009 was as follows:

	2010	2009
kWh provided	34,995,358	19,751,139
Payments for availability	\$ 2,698,038	\$ 3,347,060
Reimbursed generation costs	\$ 701,518	\$ 69,765
Market-based sales	\$ 1,764,210	\$ 1,087,401

Service Territory Settlements

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

Report of *Independent Auditors*

To the Public Utility Board City of Rochester, Minnesota

We have audited the consolidated statements of net assets of Rochester Public Utilities as of December 31, 2010 and 2009 and the related consolidated statements of revenues, expenses and changes in net assets, and cash flows for the years then ended. These financial statements are the responsibility of Rochester Public Utilities' management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed more fully in Note 1, the consolidated financial statements present only the Electric and Water Funds and do not purport to, and do not, present fairly the financial position of the City of Rochester as of December 31, 2010

and the results of its operations and the cash flows of its proprietary fund types in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Rochester Public Utilities as of December 31, 2010 and 2009, and the changes in its net assets and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

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

Smith, Schafer and Associates, Itd.

Smith, Schafer and Associates, Ltd.

Certified Public Accountants

March 29, 2011

Rochester, Minnesota

Operating and Financial *Statistics* (unaudited)

ELECTRIC	2010	2009	2008	2007	2006	2001 (10 years ago)
Retail Customers:						
Residential	43,614	43,123	42,861	42,429	41,926	37,196
General Service	4,599	4,546	4,540	4,519	4,501	3,948
Industrial / Commercial	2	2	2	2	2	2
Other	4	4	4	4	4	4
Total Retail Customers	48,219	47,675	47,407	46,954	46,433	41,150
Retail Sales: (mWh)						
Residential	345,076	325,400	328,030	342,601	333,685	281,381
General Service	643,998	633,700	640,711	640,913	623,563	588,723
Industrial / Commercial	240,438	246,180	306,828	307,952	292,580	242,412
Other	15,310	15,808	15,534	16,431	16,888	8,556,963
Total Retail Sales (mWh)	1,244,822	1,221,088	1,291,103	1,307,897	1,266,716	9,669,479
Retail Revenue:						
Residential	\$41,706,952	\$39,405,261	\$37,790,777	\$37,758,843	\$33,537,874	\$23,182,844
General Service	61,730,430	60,130,384	57,912,677	55,981,623	49,559,854	38,046,675
Industrial / Commercial	19,389,007	18,984,349	21,159,879	20,276,556	17,183,144	12,904,764
Other	5,154,490	4,573,021	4,544,124	4,520,208	2,088,066	1,604,468
Total Retail Revenue	\$127,980,879	\$123,093,015	\$121,407,457	\$118,537,230	\$102,368,938	\$75,738,751
Steam Sales (MLBs)	453,280	438,810	346,449	391,828	165,676	—
Steam Revenues	\$5,555,370	\$5,178,145	\$3,771,825	\$4,449,701	\$2,617,899	—
Annual Peak (Megawatts)	278.3	261.0	270.4	276.2	288.3	250.4
Total mWh Generated	44,640	66,726	231,848	395,558	304,571	300,149
Total mWh Purchased	1,260,920	1,235,082	1,324,665	1,338,176	1,287,672	1,155,556
Year End Cash & Investment Balance	\$44,813,640	\$46,566,146	\$40,265,406	\$61,308,702	\$22,477,464	\$24,455,887
WATER	2010	2009	2008	2007	2006	2001 (10 years ago)
Retail Customers:						
Residential	33,547	33,337	33,044	32,671	32,143	27,589
Industrial / Commercial	3,404	3,395	3,369	3,399	3,384	2,915
Total Retail Customers	36,951	36,732	36,413	36,070	35,527	30,504
Retail Sales: (ccf)						
Residential	2,817,200	3,007,600	3,070,783	3,180,064	3,176,005	2,853,453
Industrial / Commercial	2,800,228	2,877,666	2,995,159	3,189,389	3,081,764	3,111,917
Total Retail Sales (ccf)	5,617,428	5,885,266	6,065,942	6,369,453	6,257,769	5,965,370
Retail Revenue:						
Residential	\$4,170,552	\$4,202,344	\$4,221,429	\$4,257,801	\$4,017,533	\$2,959,844
Industrial / Commercial	2,672,797	2,680,653	2,750,233	2,865,348	2,643,985	2,164,850
Public Fire Protection	545,114	541,544	536,193	528,748	494,712	291,665
Total Retail Revenue	\$7,388,463	\$7,424,541	\$7,507,855	\$7,651,897	\$7,156,230	\$5,416,359
Total Pumped (billion gallons)	4.5	4.7	4.8	5.1	5.1	4.8
Year End Cash & Investment Balance	\$6,921,137	\$5,869,010	\$5,332,076	\$3,843,521	\$3,330,428	\$2,226,901

General *Information*

Rochester Public Utilities *Leadership*

Larry Koshire, **General Manager**
Mark Kotschevar, **Director of Core Services**
Susan Parker, **Director of Corporate Services**
Joe Hensel, **Director of Field Services**
Walter Schlink, **Director of Power Resources**

Utility *Board*

Jerry Williams, **Board President**, *Retired*
Dave Reichert, **Board Member**, *Facilities Engineering Manager, IBM*
Dick Landwehr, **Board Member**, *President and CEO, Mariah Group Inc.*
Roger Stahl, **Board Member**, *Attorney; Wendland, Utz, Stahl, Mintz, Ltd.*
Dennis Hanson, **Board Member & City Council Liaison**, *City Council President, City of Rochester & Vice President of Business Development, Carpet One*

Advisors and *Consultants*

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

Utility *Headquarters*

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