

Committed to Our **Customers and Community**

2011 ANNUAL REPORT





Thank You to Our Photo Contributors:

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Letter from Management

Looking back over the past year, it has been truly evident that our employees make RPU what it is today. We have been able to accomplish many things this year, many that were certainly challenging in today's economic conditions.

There are many accomplishments to list, but we'd like to highlight some of the more noteworthy ones from this past year. Throughout the year, we paid special attention to remaining fiscally sound and increasing our environmental stewardship efforts. We are pleased with how our year ended, and that we were able to keep rates stable for our customers for another year. Again, keep in mind that these accomplishments would not have come to fruition without the efforts and guidance of your neighbors, friends, and local leaders who work at RPU or serve on the RPU Board. Some of those successes are:

- **NO RATE INCREASE FOR RPU CUSTOMERS**

Thanks to rigorous internal cost controls, we are pleased to report that for the fourth straight year for water and the second straight year for electricity, there was no rate increase for RPU customers in 2011. We know the financial impact to our customers from our national economic slowdown, and thus have taken care to conserve our costs. Special credit goes to our RPU employees, who have figured ways to do "more with less" while continuing to provide excellent service and reliability.

- **A 2.1% INCREASE IN 2011 RETAIL REVENUE AND INCREASED LOCAL ECONOMIC ACTIVITY**

Based on our audited financial data, RPU had retail revenue of \$138.3 million in 2011, a 2.1% increase from 2010 retail revenue of \$135.4 million. The most recent Quarterly Economic Report (Fourth Quarter, 2011) from the Rochester Area Economic Development, Inc., reports

that the Rochester area saw gains in employment (up 1.4% from 2010), homes sales (a 7.8% increase), and building activity (permit valuations up 2.9%). RPU employs over 200 workers between the RPU Service Center and the Silver Lake Plant, all of which contribute to the vitality of the local Rochester economy.

- **COMMITMENT TO ELECTRIC VEHICLES**

You may have noticed our newest fleet vehicle, the RPU-branded Chevrolet Volt, motoring around town, or one of our three electric vehicle charging stations in Rochester. They are representative of our commitment to supporting local interest in electric vehicles. In addition, as Rochester continues to welcome visitors from out of town, we are prepared to provide them with their charging needs as consumers increase use of electric vehicles.

- **ENVIRONMENTAL ACHIEVEMENT AWARDS**

We were especially pleased this year to recognize eight recipients for their role in positively benefiting the local environment in Rochester and Olmsted County. Activities of the 2011 award recipients included leading important storm water management projects, teaching about animal habitat and rehabilitation, and building a resource center in southern Minnesota. Since 1992, more than 110 local individuals, businesses and organizations have received this award.

- **ELECTRIC AND WATER SALES**

Despite the humid summer, retail kilowatt-hour sales declined slightly by 0.3% from 2010. The warm, drier weather did however help to increase water sales by 3.7% over the previous year. Modest increases in customer growth were seen in both the electric and water utility. 1,188 new electric customers were added along with 318 new water customers.

- **CONSERVATION EFFORTS**

RPU continues to be a leader in the community in helping conserve natural resources and act as a positive environmental steward. By doing so, we help promote a healthy environment, delay the need for additional generating facilities, and reduce the need to purchase additional power during peak demand periods. In 2011, by working with our customers, RPU reduced water consumption by more than 10 million gallons, and reduced electric consumption by more than 20 million kilowatt-hours. As a result of our energy conservation efforts and energy from RPU's renewable resources including hydroelectric output from the Lake Zumbro dam, we were able to reduce our carbon footprint. In 2011, we were able to show an offset of carbon dioxide emissions of more than 36,317 tons!

We are proud of all that we have accomplished this past year. Looking ahead, we understand that it is never an easy path to accomplishing great things, but we are certainly looking forward to new challenges ahead.

Sincerely,

Larry J. Koshire
Larry Koshire, General Manager

Jerry Williams
Jerry Williams, Board President



Since 1992, more than 110 local individuals, businesses and organizations have received the Environmental Achievement Award from Olmsted County and Rochester Public Utilities.



Putting Customers First

WE ASKED; YOU RESPONDED!

During each quarter of 2011, RPU sent out customer satisfaction surveys to approximately 1,000 randomly selected customers, through an independent research firm. By year-end, almost 4,000 were mailed out and 858 (22%) were returned.

We're pleased to report that 80% of respondents were "completely" or "mostly" satisfied with RPU as a utility provider.

Here is a brief summary of highlights from the customer surveys:

- 87% of respondents were completely or mostly satisfied with the reliability of the power, water, and other services from RPU.
- 81% were completely or mostly satisfied with the ease of doing business with RPU.
- 79% stated they were completely or mostly satisfied with RPU's quality of service to its customers.
- 69% were completely or mostly satisfied with RPU's efforts to be environmentally friendly.
- 57% were completely or mostly satisfied in the value for the money with RPU.

We are pleased that so many RPU customers took the time to respond to these surveys. This valuable feedback from our customers will allow us to pinpoint areas for improvement and refinement in the future!

NO RATE INCREASE

One of the issues that came through loud and clear in our surveys is that customers want RPU to remain fiscally conservative and to keep rates affordable. We were able to forego any rate increase for water service for a fourth straight and for electric service for a second year. From 2010 to 2011, RPU maintained an essentially level budget: we focused on internal cost reductions, rather than passing our additional costs along to customers. We watched spending closely and we scrutinized open employment positions on a case-by-case basis. In addition, RPU has reduced its expenses for facility maintenance and construction. We also, deferred capital expenditures as much as possible without compromising safety and system reliability.

RPU's focus on fiscal responsibility means more money for our customers to use for other purposes, such as supporting Rochester's local businesses and economy!

RAEDI

Rochester Area Economic Development, Inc.



**RPU generates \$190.6 million
in local economic activity**



**RPU's total job impact for
our community is 542 jobs**

Local Economic Impact of RPU

RPU not only provides Rochester residents with a local, reliable, and cost-competitive source for electricity and water, but is also a prime catalyst for local economic activity.

According to Rochester Area Economic Development Inc. (RAEDI), RPU's total operating revenue of \$150.7 million for 2011 generated an additional \$39.8 million of local economic activity. Using a financial multiplier, RAEDI was further able to attribute a total of \$190.6 million of local economic activity to RPU.

Additionally, RPU's workforce of approximately 200 employees generates sufficient local economic activity to support an additional 342 jobs in the area. Thus, the total job impact of RPU in our community is 542 jobs.

Many local businesses and organizations rely on RPU every day. Keeping customers informed and in touch with what is happening with RPU is vitally important both to the health of RPU and commerce in Rochester.





Communicating *and* Listening

By listening to our customers, we have been able to better understand what they want from RPU. Many RPU customers strive to make energy-efficient decisions, but until recently, may have wished for more guidance about how to do so. Two new tools – a monthly publication, *Plugged In*, and our newly enhanced website, www.rpu.org – are putting helpful information right at customers' fingertips.

Plugged In was launched in September in response to quarterly survey feedback from customers requesting more RPU information and updates. Each month, a new issue is delivered to readers' mailboxes, providing news about RPU, such as important neighborhood projects and decisions from the RPU Board of Directors. The publication also keeps readers informed about cost-saving opportunities, including rebate offers, scholarship applications, and money-saving conservation tips. RPU has also increased its electronic communication efforts by offering *Plugged In* electronically through a personal computer, tablet or smart phone, simply by clicking on the link on RPU's website.

An additional improvement to the customer experience includes the entire redesign of the RPU website, www.rpu.org, making the site easier to navigate and use. Customers visiting the site can learn about news and events such as the Neighborhood Energy Challenge, renewable energy programs, education opportunities, and more. Site enhancements also make it easier for customers to pay their monthly bill using online bill pay or other payment options. RPU's interactive voice response (IVR) system was recently launched offering customers an additional way for customers to make payments on their schedule.



Conserving Together

In addition to making information more accessible to customers, RPU continues to work with residential and commercial customers to reduce electricity and water usage and to promote environmental stewardship. In 2011, our CONSERVE & SAVE® incentive and education program goals were to conserve 19.1 million kilowatt-hours of electricity and 5.4 million gallons of water. We exceeded those goals with final savings totals of 20,420,120 kWh saved and 10,157,238 gallons of water saved.



OUR WATER FOOTPRINT

This RPU exhibit at the Cascade Meadow Wetlands and Environmental Science Center compares water use in the U.S. to other countries and focuses on conservation tips. It shows how much water is needed to create the products we use every day. For more information about the center, visit www.cascademeadow.org.

Other conservation efforts include:

- **EDUCATION OUTREACH**

Customers took advantage of Neighborhood Energy Challenge workshops, attended community education classes on energy efficiency and renewable energy, and visited the RPU booth at the Rochester Area Builder's Home Show.

- **ENVIRONMENTAL ACHIEVEMENT AWARDS**

In 2011, eight honorees received the award for their efforts to positively affect the local environment in Rochester and Olmsted County. Since 1992, more than 110 local individuals, businesses and organizations have received the award.

- **ARBOR DAY & TREE PLANTING**

RPU continues to sponsor a community-wide Arbor Day celebration along with local tree-planting efforts and other environmental events. More than 3,000 free trees were handed out at RPU's 9th Annual Arbor Day Celebration.

- **CASCADE MEADOW WETLANDS AND ENVIRONMENTAL SCIENCE CENTER**

RPU is proud of our ongoing partnership with Cascade Meadow Wetlands and Environmental Science Center. More than 6,700 visitors toured RPU's energy and water exhibits, as well as walked the Renewable Energy Trail.

2011 Environmental Achievement Award Nominators and Honorees



RPU's 9th Annual Arbor Day Celebration



RPU's 9th Annual Arbor Day Celebration



Conservation Spotlight: Pace Dairy

In 2011, Pace Dairy received RPU's Environmental Achievement Award. The dairy worked through 2011 to reduce waste, adopt environmentally responsible practices, and become more energy efficient. Its efforts resulted in a 12.9% reduction in overall energy usage. The starting point for these achievements was an energy efficiency overview conducted by the dairy. "Essentially, we did an energy audit," says Tim Hunsucker, maintenance supervisor at Pace Dairy. "We started with an internal assessment and then brought in outside agencies to do an external audit to verify our findings." After gathering that information through the audit, Pace Dairy partnered with RPU to develop an action plan for addressing those findings.

GETTING THE PROJECT UNDERWAY

"A plethora of people were involved in the project," says Hunsucker. "Jan Blevins and Tom DeBoer were our RPU partners on this little journey." One of the first steps was creating energy and sustainability teams to direct Pace's efforts to reduce energy use. "Jan and Tom really helped us to set the foundation for a successful team," Hunsucker says. "Tom had a wealth of knowledge and helped us direct our group with data and information. Jan helped us with rebates and networking."

PUTTING PLANS INTO ACTION

"As we developed our plan and prioritized our next steps by cost and return, we also looked at our impact on the community and ways to reduce our carbon footprint," Hunsucker continues. The action points identified by Pace Dairy's energy and sustainability teams included:

- Locating and repairing air leaks in air lines throughout plant, which resulted in an estimated \$6,000 in savings.
- Installing removable valve blankets on steam pipes to prevent heat from dissipating, saving an estimated \$2,100 per year.
- Upgrading boiler controls, which increased efficiency by enabling the dairy to better match electric load and demand.

In addition, Pace Dairy addressed its community impact by reducing landfill waste. "Of the 2.6 million pounds of overall waste produced, Pace recycled 1.6 million pounds. The rest went to Olmsted incinerators, but none went to the landfills," explains Hunsucker. "To reduce waste, we had to work at changing our culture within the plant. But our employees have just been outstanding." Pace made it possible for employees to recycle everything from cardboard cores to scrap metal, plastic bands, and wood slats as part of its project.

REAPING REWARDS

In addition to garnering RPU's Environmental Achievement Award, increasing efficiency, and saving money, Pace Dairy's efforts have set them on an environmentally responsible business track. "Everyone here is concerned with how we affect our immediate community; it's our family basically and we care," Hunsucker says. In the future, Pace Dairy's energy and sustainability teams will continue to look for new ways to save energy and benefit the community. "We're trying to maximize our successes and find ways to stay involved in the community so we can invest forward."



In 2011, Pace Dairy reduced waste, adopted environmentally responsible practices, and became more energy efficient. Its efforts resulted in a 12.9% reduction in overall energy usage while recycling 1.6 million pounds of produced waste.



Continued System Expansion and Improvement

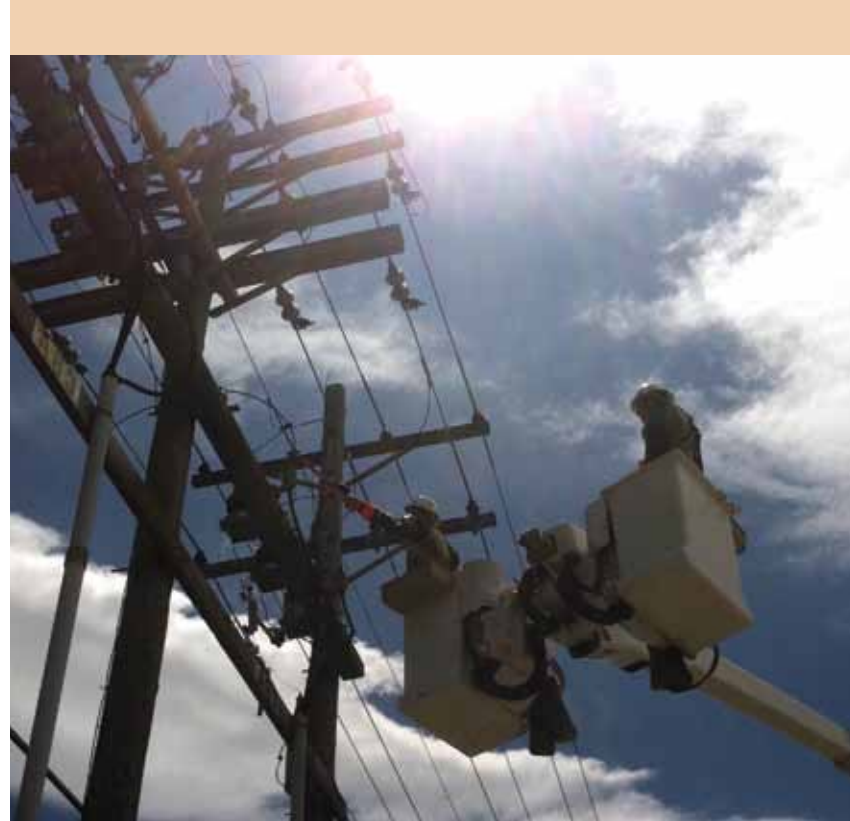
RPU has been active in CapX2020 since 2006, when formal discussions and planning began. Today, the Twin Cities-Rochester-LaCrosse line, in which RPU holds a 9 percent ownership, is in final stages of consideration by state regulators. A decision coming from the Administrative Law Judge is anticipated in early 2012. Once the route is approved, construction of the high-voltage power line could begin as early as 2013 with an in-service date of 2015.

CapX2020 will bring an aging infrastructure up to date. The project is designed to address potentially serious reliability issues in Rochester, St. Cloud, La Crosse, and the Alexandria areas. RPU's reliability will increase by adding two additional interconnections into Rochester – one at our Northern Hills substation and the other at the Chester substation east of Rochester.

RPU's system reliability was tested this past summer when a new peak demand of 292 megawatts was set on July 20. This new mark exceeded previous record of 288 megawatts set back in July of 2006.

The new transmission infrastructure will not only bolster the reliability of the existing electric grid, but it also will assure capacity for system and customer growth in the future.

For example, RPU transferred 931 customers onto the RPU system between January and September in 2011. The transfer was among RPU's largest single expansions. It involved two key elements: Changing customer's meters and updating the transformers serving them. But our line workers also had to replace old equipment, adjust for differences in equipment from the prior service provider, and ensure the safety of the existing infrastructure such as poles and wires. By the time the work was completed, 9,359 man-hours were logged to make the transition for the customers.



“This project was designed and coordinated with the customer in mind. Many RPU employees and departments worked together to ensure that the customers received the best customer service experience throughout the transfer process.”

– Mike Engle, RPU Supervisor of Distribution Design

KEEPING THE WATER FLOWING

The RPU water system continues to be a reliable source of clean drinking water for Rochester residents. As with any infrastructure, routine maintenance is necessary however. This past year, the water utility completed a number of maintenance and repair projects. A new well was also finished and put into service in 2011.



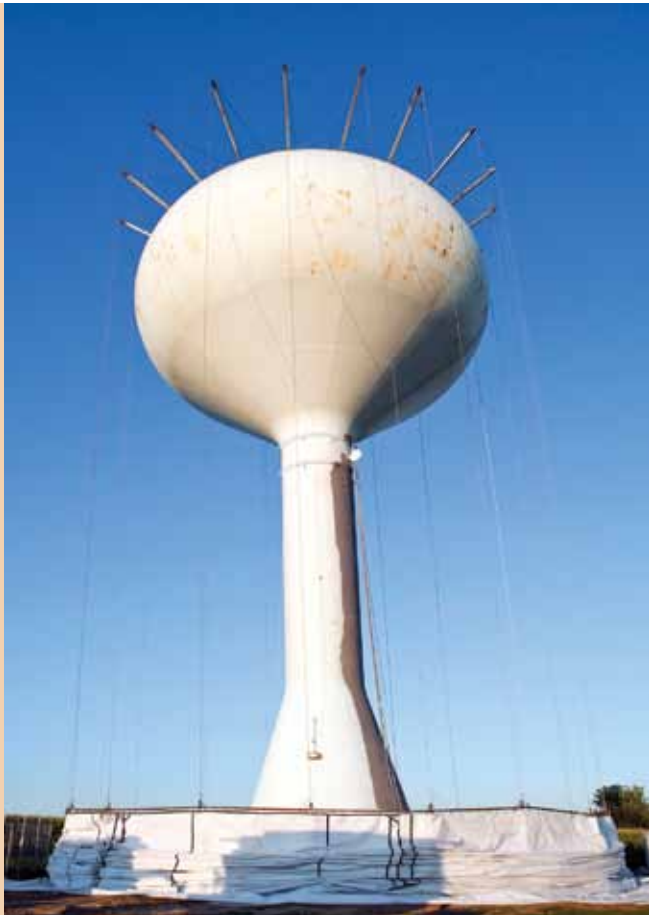
WILLOW CREEK RESERVOIR

The Willow Creek Reservoir has been in service for RPU since 1987. The concrete foundation had been deteriorating in recent years and needed repair. In fall 2011, the 1 million gallon Willow Creek Reservoir was cleaned and repaired. The glass-lined, bolted steel reservoir exterior was cleaned to remove stains. An elastomeric (rubber) liner was also installed over the existing concrete reservoir floor to eliminate leakage that had developed in recent years.



NORTH PARK WATER TOWER

This North Park Water Tower was constructed in 1995. Repairs were made during the summer and fall of 2011 to replace failed interior and exterior coatings. A full height containment shroud was installed around the tank exterior to prevent sandblasting material and paint overspray from reaching the nearby residential area.



50TH AVENUE HYDROPILLAR

Construction of the 2 million gallon storage structure began in September 2009 and was completed in June 2011. The hydropillar contains four times the storage capacity of RPU's standard spheroid towers and stands more than 137 feet tall. It is one of RPU's largest projects in recent history, increasing the total storage capacity to 15.23 million gallons of water.



INSURANCE SERVICES OFFICE (ISO) WATER DISTRIBUTION SYSTEM EVALUATION

An ISO evaluation is completed every five years to assess Rochester's municipal fire protection services, including the fire department and water distribution system. Rochester holds an ISO Class 3 Public Fire Protection Classification rating. In 2011, ISO conducted a comparison of actual water flows for fire suppression to computer models of water flows at four locations in RPU's water distribution system. ISO accepted the computerized fire flow results for 51 additional fire hydrant locations around the city. Results of the combined fire department and water system evaluation will be communicated to Rochester city administration in early 2012.



WELL #40 COMPLETION

Construction was completed on Well #40, located in southwest Rochester, which will provide water to the Airport high level system. The new well, which was placed in service on July 7, has five-times the pumping capacity of the well it replaced. In addition, it is equipped with a Variable Frequency Drive (VFD), which enables the well to run at a much lower capacity if necessary. Current system demand does not require the well to operate at full capacity, so the well is expected to operate at lower levels for the first few years.



PLANS FOR MORE WATER STORAGE IN DOWNTOWN ROCHESTER

With anticipated growth projected for downtown Rochester, it is important that we prepare now to adequately serve our customers in the future. RPU is currently working toward a permanent solution to continue providing safe, reliable drinking water in the downtown area. The main water supply for downtown Rochester and its surrounding neighborhoods today is a 1.5 million gallon reservoir high above the city's center near Saint Mary's Park. The tank and its 95 year old back-up do not hold enough water to serve customers during "peak" times – or times of heavy demand – such as hot, mid-summer days.

In the next two years, RPU plans to shore up the downtown zone's water reserves by building a new storage reservoir able to hold at least 2 million gallons – and possibly as much as 3.5 million gallons. RPU's board plans to choose among the best alternatives in June 2012, with construction beginning in fall of 2013. It will begin operating in mid-2014.



Helping Kids *Get Off to a Running Start for School*

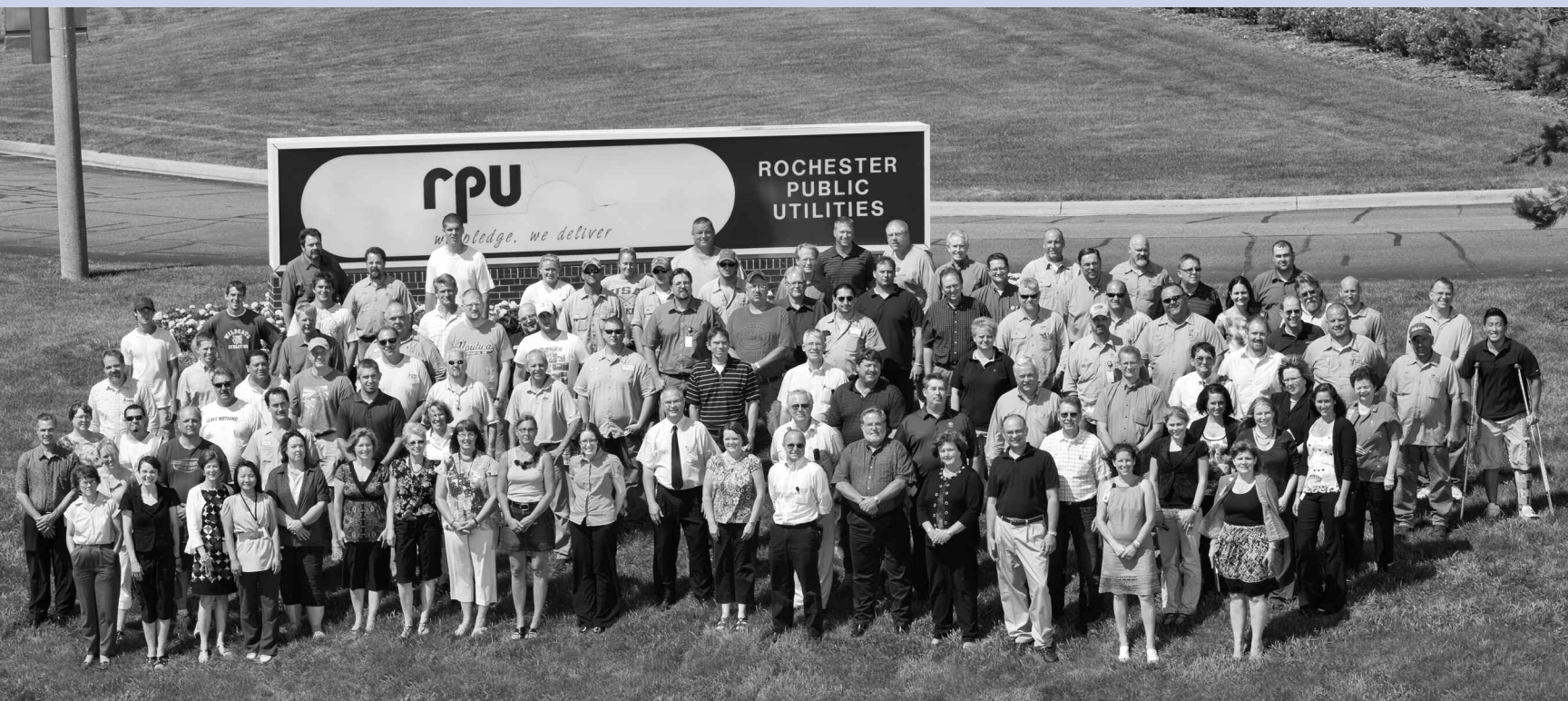
Back-to-school is an exciting time for children, but parents may find themselves swallowing hard at the check-out counter as they watch the cost of pens, paper, backpacks, and binders add up. For families who are already struggling to make ends meet, school supplies are often an added burden they just can't afford. That's why Running Start for School, a community initiative of the United Way in Olmsted County, collects donated school supplies to distribute to lower income families. This past year, RPU employees Laura Andrews, Linda Bly, and Lori Gartner, spearheaded a collection program for the campaign.

Olmsted County children in kindergarten through 12th grade who qualify for free or reduced cost lunches are eligible to receive Running Start for School donations. Last fall, 6,874 children in Olmsted County qualified to receive supplies. That translates into a need for 25,000 pencils, 2,638 erasers, 8,667 folders, 9,842 spiral notebooks, plus glue sticks, loose leaf paper, markers, binders, and backpacks! We are so pleased that through the efforts of our three volunteer leaders and the generous donations of RPU employees, our site collected and donated more than 900 items ranging from backpacks to spiral notebooks.



Committed to Our **Customers and Community**

2011 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, 2011. 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 1,188 new electric customers and 318 new water customers added in 2011. Growth for the Electric Utility doubled from 2010, primarily due to the addition of 931 customers through city annexation, while growth for the Water Utility showed a slight increase over the prior year.
- The humid summer weather had a small positive impact on revenues with an increase of 1.8%, but little impact on retail kilowatt-hour sales. Retail kilowatt-hour sales decreased 0.3% from 2010. Demand increased due to the warmer weather patterns. The annual peak demand of 292.1 megawatts was set in July, which is an increase of 5.0% over the demand of 278.3 megawatts set in August 2010. This is a new record peak, topping the previous record of 288.3 megawatts set in July 2006.
- Retail water sales (ccf) were up 3.7% in 2011 due in part to lower-than-average rainfall.
- Due to cost reduction measures implemented in 2009 and 2010, and continuing into 2011, there were no rate increases for either the Electric or Water Utility for 2011.
- Rates for power purchased from SMPA (Southern Minnesota Municipal Power Agency) remained steady in 2011, with no increase. Purchased power costs from SMPA and the MISO market represented 70% of electric operating expenses for 2011.
- The Electric Utility transferred approximately \$8.4 million, and the Water Utility transferred \$355,000 to the City of Rochester's General Fund in the form of in-lieu-of-tax payments.
- A new water storage facility, the 50th Avenue "hydropillar", was completed and put into service in 2011. One of the largest projects for the Water Utility in recent years, the tower holds two million gallons of water and increases RPU's total storage capacity to 15.23 million gallons of water.

- In September 2011 RPU, in a joint project with the Rochester Public Works department (RPW), completed installation of a shared geo-lake plate system to serve the RPU Service Center and the RPW Operations Center geothermal systems. The project was supported by federal funds and reduces the use of fossil fuels and the resulting emissions.
- RPU has been investing in smart grid technologies with regards to its electric distribution system for several years. This included installing an automated meter reading (AMR) system, which allows meter readers to collect data remotely via wireless connection and utilizing Geographic Information System (GIS) software in the outage management system. RPU is exploring other uses for these technologies that will allow them to better serve their customers. To that end, in 2011 focus groups were held to gain an understanding of customers' wants, needs and desires for smart grid technologies, and the major focus was on customer education through trade shows, published articles in "Plugged-In" (RPU's monthly magazine) and outreach programs. RPU has also begun a pilot program that involves sending a free Home Energy Report to a group of 25,000 customers. The report provides customers information on their energy use and offers easy, personalized energy saving tips. These efforts have allowed RPU to educate customers before any future changes are implemented that may impact them.
- 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.
- In the fall of 2011 RPU received the first Chevrolet Volt electric vehicle in Rochester. The vehicle is assigned to RPU's motor pool and is available for use by RPU staff. This acquisition is consistent with RPU's Green Fleet Plan, joining three hybrid electric vehicles and nine E85-fueled vehicles.
- RPU became the first utility, and the second organization in the state of Minnesota to install an electric car charging station. Three stations were installed; one in downtown Rochester, one at Rochester Community and Technical College and one at RPU's Service Center.
- RPU surpassed its Aggressive Demand-Side Management (DSM) goal for 2011 of 19,100 megawatt hours in energy savings. Actual energy savings of 20,153 megawatt hours were achieved through helping commercial and residential customers install energy efficient equipment and technologies. This represents an estimated 20,153 tons of carbon reduction. The energy savings also represents 1.5% of annual retail energy sales, meeting a legislative goal set for all Minnesota utilities to reach by 2010. RPU met this goal in 2010 as well.
- RPU receives all power and energy up to 216 megawatts from SMMPA. Most of SMMPA's energy comes from SHERCO 3. In November 2011, SHERCO 3 experienced an outage during a maintenance start up. Repairs are now underway. The unit is forecasted to be out of service for an extended period of time while repairs are made. In the interim, SMMPA has procured replacement power supply from the MISO market at a cost similar to SHERCO 3 production costs. SMMPA does not anticipate a revenue adjustment in 2012 as a result of the outage repairs or interim power supply arrangements.

Financial Analysis – Electric Utility

The following discussion provides analysis of the 2011 and 2010 comparative financial information provided in the following table.

Condensed Financial Information - Electric Utility

December 31, 2011 and 2010

(In millions)

Statement of Revenues, Expenses, & Changes in Net Assets

	<u>2011</u>	<u>2010</u>	<u>Change</u>
Operating Revenues	\$ 142.4	\$ 142.8	\$ (0.4)
Operating Expenses	125.4	127.9	(2.5)
Operating Income	17.0	14.9	2.1

Transfers Out			
(In-Lieu-Of-Tax Payments)	(8.4)	(8.4)	–
Other Income & Expense	0.2	0.4	(0.2)
Interest Expense	(3.9)	(4.2)	0.3
Nonoperating Revenue (Expense)	(12.1)	(12.2)	0.1
Change in Net Assets	4.9	2.7	2.2

Net Assets - Beginning of Year	147.6	144.9	2.7
Net Assets - End of Year	\$ 152.5	\$ 147.6	\$ 4.9

Statement of Net Assets

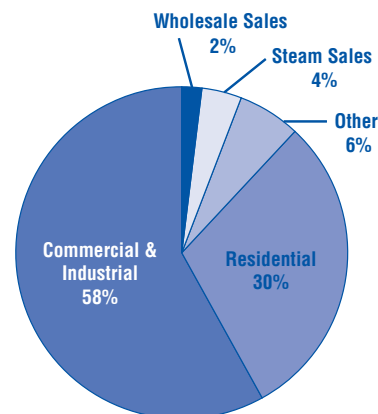
	<u>2011</u>	<u>2010</u>	<u>Change</u>
Cash and Investments	\$ 42.5	\$ 42.3	\$ 0.2
Other Current Assets	20.4	19.3	1.1
Capital Assets, Net	189.5	188.8	0.7
Other Noncurrent Assets	3.1	3.8	(0.7)
Total Assets	255.5	254.2	1.3
Current Liabilities	18.0	17.6	0.4
Long-Term Debt	82.9	86.9	(4.0)
Other Long-Term Liabilities	2.1	2.1	–
Total Liabilities	103.0	106.6	(3.6)

Invested in Capital Assets,			
Net of Related Debt	105.1	100.6	4.5
Unrestricted	47.4	47.0	0.4
Net Assets	\$ 152.5	\$ 147.6	\$ 4.9

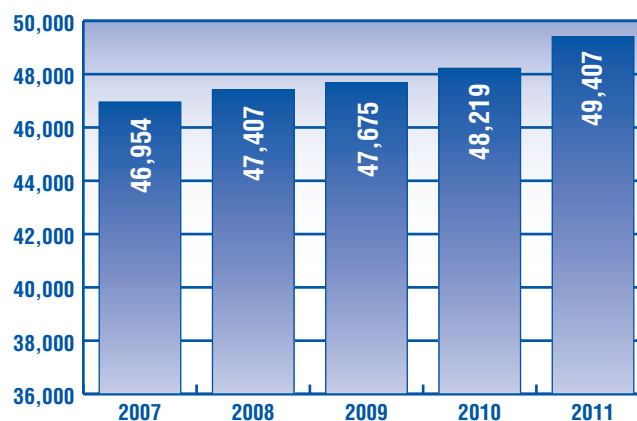
Operating Revenues

Operating revenues decreased \$0.4 million (0.3%) in 2011. This was due primarily to an increase in retail revenues of \$2.2M or 1.8%, offset by a decrease in wholesale revenues of \$2.7M or 50.4%.

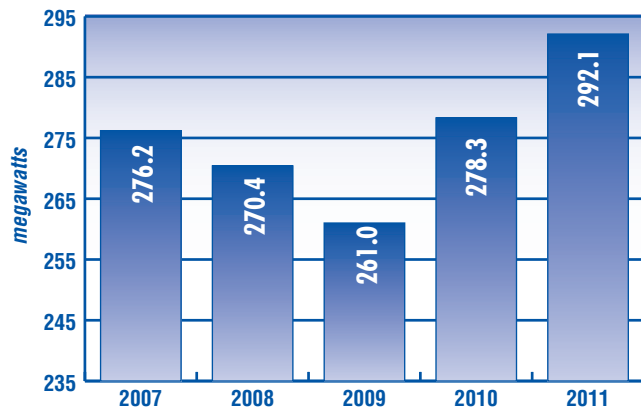
Electric Operating Revenues



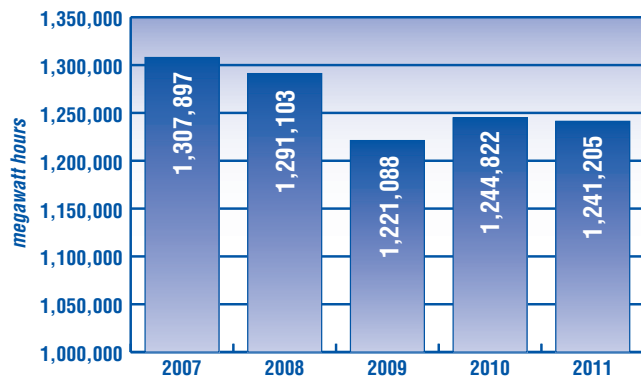
Number of Electric Customers



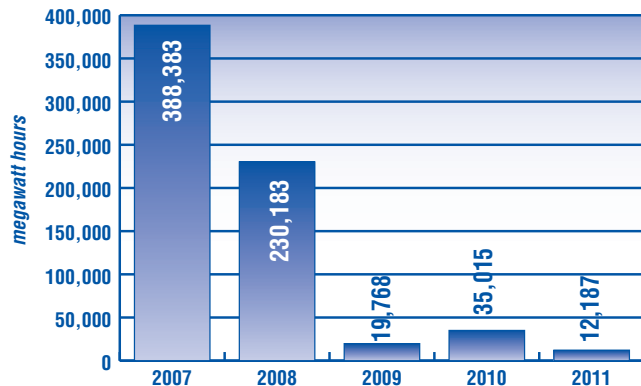
Electric Peaks



Electric Retail Sales



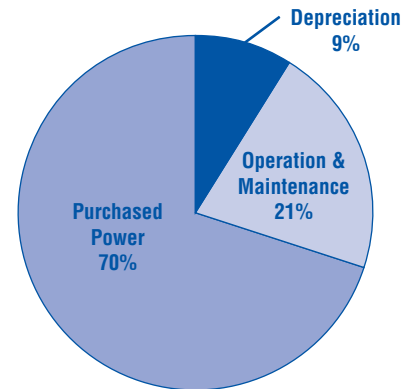
Wholesale Sales



Operating Expenses

Operating expenses decreased \$2.5 million (2.0%) in 2011, due primarily to a decrease in generation fuel costs and purchased power. The primary driver of operating expenses for the Electric Utility continues to be purchases of power from SMPA and from the MISO market, which comprised 70% of total operating expenses.

Electric Operating Expenses



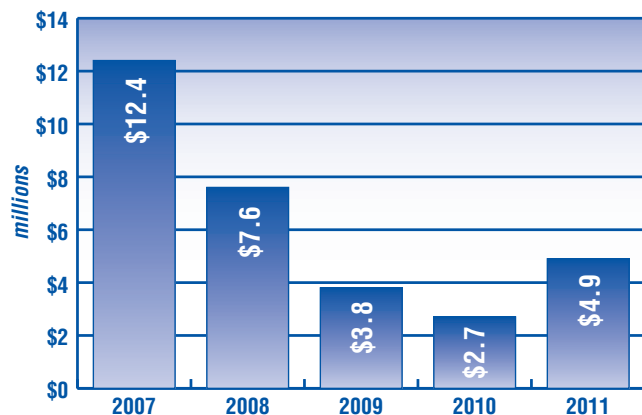
In-Lieu-of-Tax Payments

The Electric Utility transfers an amount to the City of Rochester's General Fund each month based on the amount of retail kilowatt-hours sold. Due to a slight decrease in kilowatt-hour sales the payment to the City decreased by approximately \$24,000.

Change in Net Assets

The increase in net assets for 2011 was \$4.9 million, \$2.2 million (81.5%) more than in 2010. This is primarily due to a decrease in purchased power and in materials and supplies purchased.

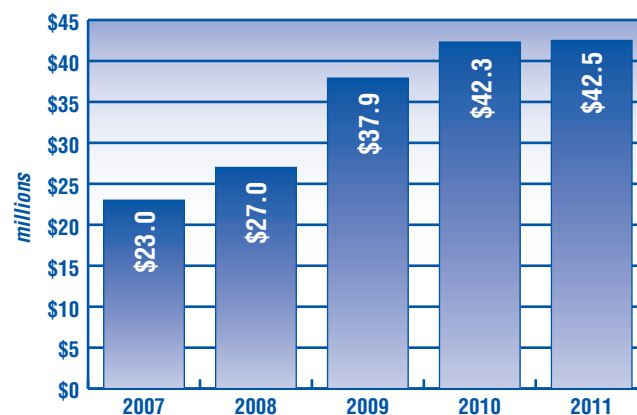
Change in Net Assets



Cash, Investments and Other Assets

The ending unrestricted cash and investments balance for 2011 was \$42.5 million, \$0.2 million higher than 2010.

Unrestricted Cash and Investments – Electric



Other current assets for 2011 were \$20.4 million, \$1.1 million higher than at the end of 2010. This increase was due primarily to an increase in accounts receivable.

Other noncurrent assets decreased by \$0.7 million in 2011, due primarily to a decrease in deferred charges. This consisted of preliminary survey and investigation costs incurred over the past several years associated with the CapX 2020 project. Now that the project is underway, these costs have been moved to assets under construction and will be capitalized when the project is completed.

Liabilities

Current liabilities increased \$0.4 million in 2011, primarily due to an increase in the amount owed to the City for sewer and stormwater revenues collected, as well as an increase in the current portion of long-term debt.

Net Assets

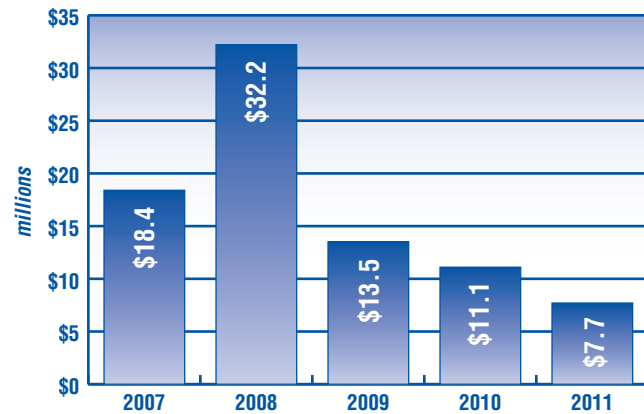
Net assets invested in capital assets, net of related debt, increased \$4.5 million. This increase reflects additions to capital assets funded through rate-based revenues, fees from customers, and debt proceeds.

Unrestricted net assets are not subject to any constraints by debt covenants or other legal requirements. In 2011, unrestricted net assets increased \$0.4 million due to the results of operations.

CAPITAL ASSETS

At December 31, 2011, the Electric Utility had \$189.5 million invested in a broad range of utility capital assets, including a coal-burning steam generation plant, two gas turbines, a hydroelectric power generation plant, two diesel generators, equipment related to providing Mayo Clinic's Prospect Plant with steam, emission reduction equipment, electric transmission and distribution lines, buildings and equipment. Capital assets increased \$10.9 million in 2011, reflecting investments in the distribution and transmission systems, and general facilities of the Electric Utility. This increase in capital assets was offset by a \$10.2 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 and major maintenance expenses decreased by \$3.4 million in 2011, due to less development activity and cost control efforts.

Capital and Major Maintenance Expenditures



LONG-TERM DEBT

At the end of 2011, the Utility had \$79.8 million in revenue bonds and \$6.5 million in revenue notes outstanding. No new debt was issued during the year and \$3.8 million was retired in 2011.

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 2011 and 2010 comparative financial information provided in the following table.

Condensed Financial Information - Water Utility

December 31, 2011 and 2010

(In millions)

Statement of Revenues, Expenses, & Changes in Net Assets

	<u>2011</u>	<u>2010</u>	<u>Change</u>
Operating Revenues	\$ 8.3	\$ 8.1	\$ 0.2
Operating Expenses	8.1	7.3	0.8
<i>Operating Income</i>	<u>0.2</u>	<u>0.8</u>	<u>(0.6)</u>

Transfers Out			
(In-Lieu-Of-Tax Payments)	(0.3)	(0.3)	–
Other Income & Expense	0.1	0.1	–
Capital Contributions	1.3	2.9	(1.6)
Nonoperating Revenue (Expense)	1.1	2.7	(1.6)
<i>Change in Net Assets</i>	<u>1.3</u>	<u>3.5</u>	<u>(2.2)</u>

Net Assets - Beginning of Year	91.5	88.0	3.5
<i>Net Assets - End of Year</i>	<u>\$ 92.8</u>	<u>\$ 91.5</u>	<u>\$ 1.3</u>

Statement of Net Assets

	<u>2011</u>	<u>2010</u>	<u>Change</u>
Cash and Investments	\$ 6.5	\$ 6.9	\$ (0.4)
Other Current Assets	0.7	0.4	0.3
Capital Assets, Net	87.0	85.8	1.2
<i>Total Assets</i>	<u>94.2</u>	<u>93.1</u>	<u>1.1</u>

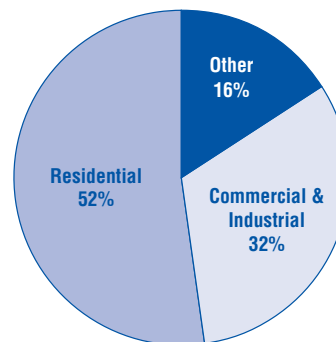
Current Liabilities	1.2	1.4	(0.2)
Other Long-Term Liabilities	0.2	0.2	–
<i>Total Liabilities</i>	<u>1.4</u>	<u>1.6</u>	<u>(0.2)</u>

Invested in Capital Assets, Net of Related Debt	87.0	85.8	1.2
Unrestricted	5.8	5.7	0.1
<i>Net Assets</i>	<u>\$ 92.8</u>	<u>\$ 91.5</u>	<u>\$ 1.3</u>

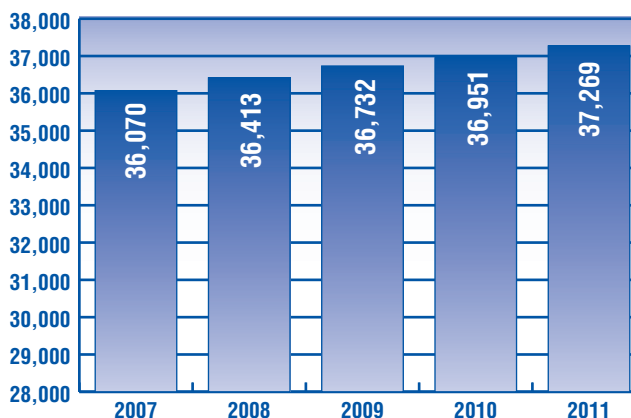
Operating Revenues

Operating revenues increased by \$188,000 (2.3%) in 2011. Rates from 2010 were not changed. Sales volume increased by 3.7%, however, utility service revenues increased by only 2.6%. 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.

Water Operating Revenues



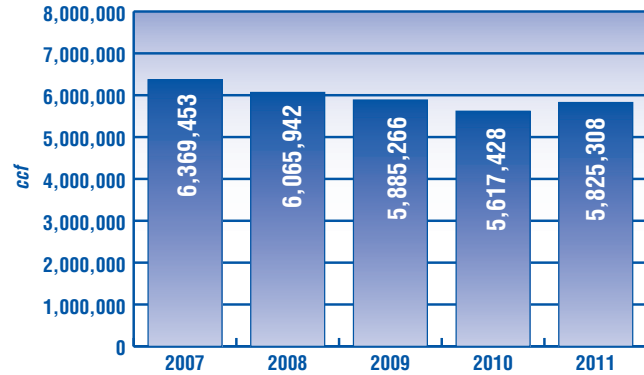
Number of Water Customers



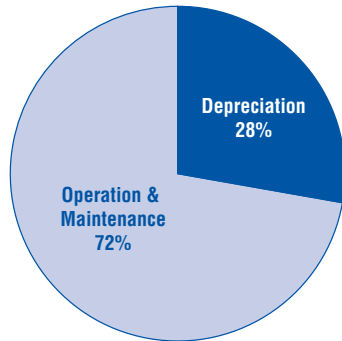
Operating Expenses

Operating expenses increased by \$823,000 (11.3%) in 2011. This was primarily due to increases in materials and supplies expense and salaries expense.

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 increase in ccf sold in 2011, payments to the City increased by approximately \$13,000.

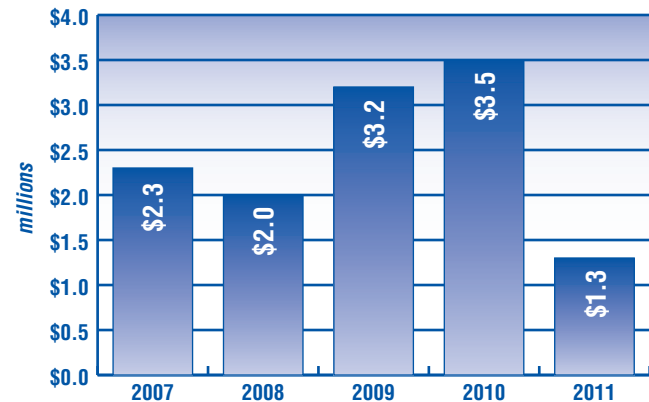
Capital Contributions

Capital contributions decreased \$1.6 million in 2011. 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 2011 was \$1.3 million, \$2.2 million lower than in 2010. This is primarily due to a decrease in reported capital contributions in 2011.

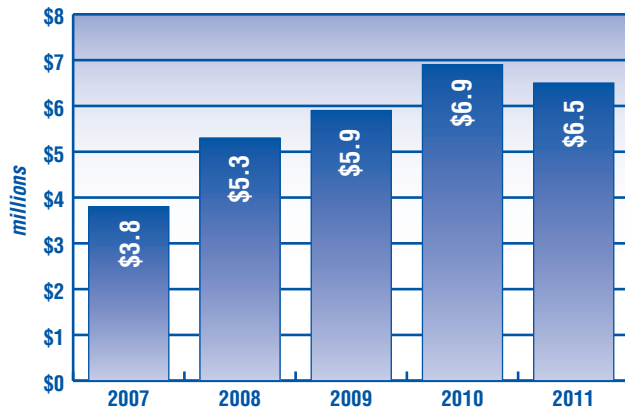
Change in Net Assets



Cash, Investments and Other Assets

The ending unrestricted cash and investments balance for 2011 was \$6.5 million, \$0.4 million lower than 2010 due to a decrease in cash provided by operations.

Unrestricted Cash and Investments – Water



Other current assets increased by \$263,000 in 2011, due to an increase in accounts receivable and accrued revenues.

Liabilities

Current liabilities decreased \$163,000 in 2011 due to a decrease in the amount owed to the City at the end of 2011.

Net Assets

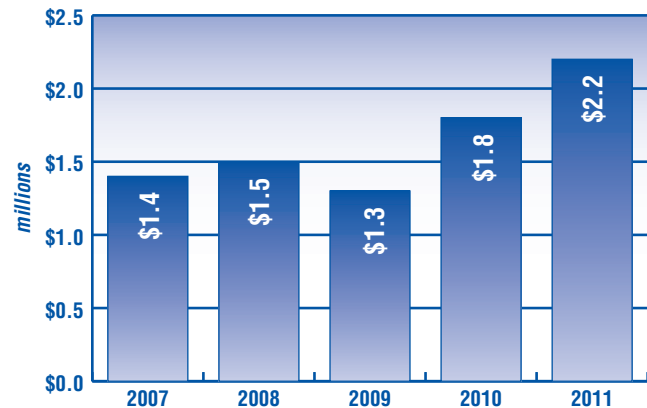
Net assets invested in capital assets, net of related debt, increased \$1.2 million. This increase reflects additions to capital assets. Capital expenditures for the Water Utility are funded through rate-based revenues, fees from customers and debt proceeds.

Unrestricted net assets are not subject to any constraints established by debt covenants or other legal requirements. In 2011, unrestricted net assets increased \$0.1 million due to the results of operations.

CAPITAL ASSETS

At December 31, 2011, the Water Utility had \$87.0 million invested in a broad range of utility capital assets, including 20 water storage facilities, 33 wells, water mains, pump station facilities, buildings, and equipment. Capital assets increased \$3.4 million in 2011, 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 and major maintenance expenses increased by \$400,000 in 2011, due to some larger projects and more work being completed in 2011. Some of the major components of capital spending in 2011 were a land purchase, City projects, a new well, water storage facility maintenance, well maintenance and spending on water meters and automated meter reading.

Capital and Major Maintenance Expenditures



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 2010, the Utility Board voted to have no rate increase for 2011 for both the Electric and Water Utilities. The Electric Utility had rate increases in 2008 and 2009, followed by two years of no rate increases. The Water Utility has had not had a rate increase since 2007. This has been the result of careful planning and continued aggressive cost control measures, and has been a way for RPU 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
2012*	2.5%	0.0%	0.0%
2011	3.2%	0.0%	0.0%
2010	1.7%	0.0%	0.0%
2009	(0.4%)	5.0%	0.0%
2008	3.9%	4.0%	0.0%
Annualized Average	2.2%	1.8%	0.0%

*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 slow housing market, growth of the city has remained slow as well. In 2011 there were 208 building permits totaling \$42.1 million issued for single-family homes as compared to 200 permits totaling \$41.4 million in 2010. The increase in commercial building permits was slightly higher, numbering 47 for 2011 totaling \$62.6 million as compared to 41 commercial permits valued at \$52.3 million in 2010.

The December 2011 unemployment rate of 4.7% for the area remains well below the state and national rates of 5.8% and 8.5%, 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 5.4%.

After examining all of these factors in the budgeting process, RPU has projected electric rates to increase modestly over the next five years, while water rates are expected to remain steady. However, taking into account the current economic conditions and the effect it has had on customers, management has felt it prudent to recommend no electric rate increase for 2012 as it did in 2011 and 2010. RPU management and employees were able to make this possible by continuing to hold costs down.

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	
	2011	2010
Operating Revenues:		
Electric:		
Retail	\$130,698,001	\$127,980,879
Wholesale	2,666,088	5,376,520
Other	9,048,830	9,411,056
Water	8,320,952	8,132,956
Total Operating Revenues	150,733,871	150,901,411
Operating Expenses:		
Purchased Power	87,915,718	88,157,635
Operations and Maintenance	32,700,100	35,770,208
Depreciation	12,897,099	11,233,005
Total Operating Expenses	133,512,917	135,160,848
Operating Income	17,220,954	15,740,563
Nonoperating Income (Expenses):		
Investment Income	639,208	962,687
Interest Expense	(3,856,639)	(4,194,967)
Miscellaneous, Net	(432,783)	(509,808)
Total Nonoperating Income (Expenses)	(3,650,214)	(3,742,088)
Income Before Transfers/Capital Contributions	13,570,740	11,998,475
Transfers Out	(8,734,117)	(8,745,642)
Capital Contributions	1,262,600	2,909,926
Change in Net Assets	6,099,223	6,162,759
Net Assets, Beginning of Year	239,152,370	232,989,611
Net Assets, End of Year	\$245,251,593	\$239,152,370

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

Income by Segments of Business

2011	Electric	Water	Total
Operating Revenues:			
Retail	\$130,698,001	\$7,580,968	\$138,278,969
Wholesale	2,666,088	—	2,666,088
Other	9,048,830	739,984	9,788,814
Total Operating Revenues	142,412,919	8,320,952	150,733,871
Operating Expenses	125,429,806	8,083,111	133,512,917
Operating Income	16,983,113	237,841	17,220,954
Nonoperating Income (Expense)	(3,729,524)	79,310	(3,650,214)
Income Before Transfers/Capital Contributions	13,253,589	317,151	13,570,740
Transfers Out	(8,378,132)	(355,985)	(8,734,117)
Capital Contributions	—	1,262,600	1,262,600
Change in Net Assets	\$4,875,457	\$1,223,766	\$6,099,223

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

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

Consolidated Statements of Net Assets

	December 31	
	2011	2010
ASSETS:		
Current Assets:		
Cash and Cash Equivalents (Note 3)	\$7,022,031	\$6,860,969
Investments	42,034,903	42,373,881
Accounts Receivable and Accrued Utility Revenues	13,376,934	11,514,807
Fossil Fuel Inventory	2,374,245	2,776,077
Materials and Supplies Inventory	5,261,529	5,308,314
Other Current Assets	84,353	74,701
Total Current Assets	70,153,995	68,908,749
Non-Current Assets:		
Restricted Assets (Note 4):		
Investments	2,504,517	2,499,927
Deferred Charges:		
Unamortized Bond Issuance Costs	618,916	705,515
Other	—	591,697
Total Deferred Charges	618,916	1,297,212
Capital Assets:		
Construction Work in Progress	9,948,367	20,864,999
Land and Land Rights	3,995,924	3,415,683
Depreciable Assets, Net (Note 5):		
Electric	178,251,726	170,896,940
Water	84,246,253	79,514,291
Net Capital Assets	276,442,270	274,691,913
Total Non-Current Assets	279,565,703	278,489,052
Total Assets	\$349,719,698	\$347,397,801

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

	December 31	
	2011	2010
LIABILITIES:		
Current Liabilities:		
Accounts Payable	\$9,556,085	\$9,398,966
Due to Other Funds	2,460,113	2,340,551
Accrued Compensation and Compensated Absences	2,260,316	2,362,355
Customer Deposits	523,920	493,010
Interest Payable	303,007	309,390
Current Maturities of Long Term Debt (Note 6)	4,029,714	3,824,362
Deferred Credits	241,362	258,157
Total Current Liabilities	19,374,517	18,986,791
Non-Current Liabilities:		
Accrued Compensated Absences	1,535,700	1,588,963
Accrued Claims	35,000	40,000
Long-Term Debt (Note 6)	82,857,513	86,927,882
Unearned Lease Revenues	665,375	701,795
Total Non-Current Liabilities	85,093,588	89,258,640
Commitments and Contingencies (Note 10)		
Total Liabilities	\$104,468,105	\$108,245,431
NET ASSETS:		
Invested in Capital Assets, Net of Related Debt	\$192,059,560	\$186,439,596
Unrestricted Net Assets	53,192,033	52,712,774
Total Net Assets	\$245,251,593	\$239,152,370

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

Consolidated Statements of Cash Flows

	Years Ended December 31	
	2011	2010
Cash Flows From Operating Activities:		
Cash Received from Customers	\$143,947,327	\$145,597,441
Cash Paid to Suppliers and Employees	(119,912,419)	(123,332,807)
Internal Activity – Payments From Other Funds	5,509,558	5,415,582
Net Cash Provided By Operating Activities	29,544,466	27,680,216
Cash Flows From Noncapital Financing Activities:		
Operating Transfers to Other Funds	(8,798,802)	(8,724,434)
Cash Flows From Capital and Related Financing Activities:		
Additions to Utility Plant and Other Assets	(13,630,813)	(11,637,198)
Service Territory Acquisition	(650,272)	(948,198)
Payments on Bonds and Notes Payable Obligations	(7,685,899)	(8,423,149)
Net Cash (Used In)		
Capital and Related Financing Activities	(21,966,984)	(21,008,545)
Cash Flows From Investing Activities:		
Interest Received	1,047,994	1,352,383
(Increase) Decrease in Investments	334,388	(5,426,766)
Net Cash (Used In) Investing Activities	1,382,382	(4,074,383)
Net Increase (Decrease) in Cash and Cash Equivalents	161,062	(6,127,146)
Cash and Cash Equivalents, Beginning of Year	6,860,969	12,988,115
Cash and Cash Equivalents, End of Year	\$7,022,031	\$6,860,969
Reconciliation of Operating Income to Net Cash Provided by Operating Activities:		
Operating Income	\$17,220,954	\$15,740,563
Adjustments to Reconcile Operating Income to		
Net Cash Provided by Operating Activities:		
Depreciation	12,897,099	11,233,005
Bad Debts	310,977	123,930
Other	(388,305)	(476,013)
(Increase) Decrease In:		
Accounts Receivable and Accrued Utility Revenues	(2,173,106)	(209,546)
Inventories	448,617	3,693,126
Prepaid and Other Current Assets	68,744	92,963
Increase (Decrease) In:		
Accrued Liabilities and Accounts Payable	1,181,791	(2,174,852)
Customer Deposits	30,910	39,053
Unearned Lease Revenues	(36,420)	(36,420)
Other	(16,795)	(345,593)
Net Cash Provided by Operating Activities	\$29,544,466	\$27,680,216
Non-Cash Capital and Related Financing Activities:		
Additions to Utility Plant and Other Assets Contributed By:		
City's Governmental Funds	\$842,218	\$2,831,933
Developers	\$420,382	\$77,993
Equipment Purchases in Accounts Payable	\$1,062,614	\$2,472,143

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 2010 financial statements to conform to the 2011 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 \$4,867,158 and \$3,883,101 for the years ended December 31, 2011 and 2010, respectively.

Sales to the Utilities single largest customer were \$22,183,485 (\$16,671,153 retail and \$5,512,332 other) and \$21,731,988 (\$16,176,619 retail and \$5,555,369 other) in 2011 and 2010, respectively. During the year ended December 31, 2011, no other customer accounted for more than 10% of operating revenues. Sales to other funds of the City of Rochester were \$4,917,455 and \$4,871,890 for the years ended December 31, 2011 and 2010, 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 2011 Comprehensive Annual Financial Report.

NOTE 4: Restricted Assets

Under the provisions of the 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 \$2,504,517 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.

NOTE 5: Capital Assets

Major classes of depreciable assets and total accumulated depreciation as of December 31, 2011 and 2010 are as follows:

	2011	2010
Intangible Plant Assets	\$ 14,042,587	\$ 11,715,783
Buildings, Structures, and Improvements	49,010,544	44,069,725
Installations, Equipment, and Fixtures	360,044,243	342,750,549
Total Depreciable Assets	423,097,374	398,536,057
Less: Accumulated Depreciation	160,599,394	148,124,826
Net Depreciable Assets	\$ 262,497,980	\$ 250,411,231

In 2011, capital assets totaling \$842,218 were contributed to the Utility by other funds of the City of Rochester, and \$420,382 were contributed to the Utility by others.

NOTE 6: Long-Term Debt

At December 31, 2011 and 2010, long-term debt consisted of the following:

	2011	2010
Revenue Bonds, Series 2007C 4.00% - 5.00%, due each December 1 through 2030	\$ 74,370,000	\$ 75,515,000
Revenue Bonds, Series 2002A 3.00% - 4.50%, due each December 1 through 2017	5,400,000	6,170,000
Revenue Note Payable, principal due each December 1 through 2014, interest at variable rate, currently 0.09%, ongoing line of credit fees and administrative fees due each June 1 and December 1	2,390,000	3,035,000
Revenue Note Payable, principal due each December 1 through 2014, interest at variable rate, currently 0.09%, ongoing line of credit fees and administrative fees due each June 1 and December 1	4,120,000	5,380,000
Capital lease obligations	12,505	16,867
Less: Unamortized Discount	159,857	172,910
Less: Unamortized Deferred Amount on Refunding	1,515,371	1,651,850
Plus: Unamortized Premium	2,269,950	2,460,137
Less: Current Maturities	4,029,714	3,824,362
Total Long-Term Debt	\$ 82,857,513	\$ 86,927,882

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. 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, 2011 and 2010 was \$1,515,371 and \$1,651,850 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, 2011, including interest payments of \$43,373,327 are as follows:

	Revenue Bonds	Notes Payable
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	—
2016	6,606,650	—
Thereafter	92,517,575	—
Total	\$ 122,625,656	\$ 7,027,671

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 1,252,131,977 and 1,254,839,127 kilowatt hours totaling \$87,012,687 and \$87,705,689 from SMMPA during the years ended December 31, 2011 and 2010, 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, 2011 were \$1,994,004 of which \$1,070,854 was made by the Utility and \$923,150 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, 2011 and 2010 was \$51,831 and \$59,047, respectively.

NOTE 9: Legal Matters

In 2005, the City of Rochester brought a claim against Southern Minnesota Municipal Power Agency (SMPMPA), its primary wholesale power supplier, over cost responsibility for new generating resources and SMPMPA's rate setting methods. SMPMPA filed counterclaims concerning the City's (RPU) use of its Silver Lake Plant for selling steam to a local customer and the position that the SMPMPA Board has virtually unlimited discretion in setting rates.

In May 2009, the Court issued a decision that denied the City's requested relief as to cost responsibility for new generation resources, granted portions of SMPMPA's counterclaims concerning its rate setting authority but denied the remainder. In March 2010, the Court issued a final order granting SMPMPA'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.

In November 2010, the City of Rochester/Rochester Public Utilities received a request for information from the U.S. Environmental Protection Agency (EPA) regarding the four units at the Silver Lake Power Plant. The information request was made under the provisions of Section 114 of the Clean Air Act. Over the past years in cases involving investor-owned utility power plants, the information requests have been followed by EPA allegations of Clean Air Act violations which, in turn, have resulted in litigation or settlements resolving those allegations. The EPA is now reviewing municipally-owned utilities which is why RPU received this Section 114 Request. The EPA has indicated that this request would result either in a settlement or in litigation between Rochester and the EPA. Currently, the parties continue to discuss a possible settlement of this matter however the timing and amount of potential settlement costs are unknown at this time. Management believes any likely resolution would not have a material adverse effect on the Utilities' financial statements.

NOTE 10: Commitments and Contingencies*Risk Management Program*

The City of Rochester has established a self-insurance program for group health coverage and workers' compensation. Rochester Public Utilities participates in this self-insurance program. The group health program is limited to losses of \$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, 2011 and 2010 was as follows:

	2011	2010
kWh provided	12,048,787	34,995,358
Payments for availability	\$ 1,701,292	\$ 2,698,038
Reimbursed generation costs	\$ 102,819	\$ 701,518
Market-based sales	\$ 827,318	\$ 1,764,210

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. 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, 2011 and 2010 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, 2011

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, 2011 and 2010, 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, Inc.

Smith, Schafer and Associates, Ltd.
Certified Public Accountants
March 22, 2012
Rochester, Minnesota

Operating and Financial Statistics (unaudited)

ELECTRIC	2011	2010	2009	2008	2007	2002 (10 years ago)
Retail Customers:						
Residential	44,700	43,614	43,123	42,861	42,429	38,259
General Service	4,701	4,599	4,546	4,540	4,519	4,030
Industrial / Commercial	2	2	2	2	2	2
Other	4	4	4	4	4	4
Total Retail Customers	49,407	48,219	47,675	47,407	46,954	42,295
Retail Sales: (mWh)						
Residential	346,088	345,076	325,400	328,030	342,601	302,755
General Service	642,712	643,998	633,700	640,711	640,913	608,230
Industrial / Commercial	236,880	240,438	246,180	306,828	307,952	243,121
Other	15,525	15,310	15,808	15,534	16,431	16,157
Total Retail Sales (mWh)	1,241,205	1,244,822	1,221,088	1,291,103	1,307,897	1,170,263
Retail Revenue:						
Residential	\$42,565,163	\$41,706,952	\$39,405,261	\$37,790,777	\$37,758,843	\$25,569,567
General Service	62,924,479	61,730,430	60,130,384	57,912,677	55,981,623	40,155,746
Industrial / Commercial	19,455,536	19,389,007	18,984,349	21,159,879	20,276,556	13,093,886
Other	5,752,823	5,154,490	4,573,021	4,544,124	4,520,208	1,650,037
Total Retail Revenue	\$130,698,001	\$127,980,879	\$123,093,015	\$121,407,457	\$118,537,230	\$80,469,236
Steam Sales (MLBs)	459,491	453,280	438,810	346,449	391,828	—
Steam Revenues	\$5,512,332	\$5,555,370	\$5,178,145	\$3,771,825	\$4,449,701	—
Annual Peak (Megawatts)	292.1	278.3	261.0	270.4	276.2	254.5
Total mWh Generated	25,375	44,640	66,726	231,848	395,558	144,261
Total mWh Purchased	1,263,798	1,260,920	1,235,082	1,324,665	1,338,176	1,179,944
Year End Restricted / Unrestricted Cash & Investment Balance	\$45,025,194	\$44,813,640	\$46,566,146	\$40,265,406	\$61,308,702	\$23,532,042
WATER	2011	2010	2009	2008	2007	2002 (10 years ago)
Retail Customers:						
Residential	33,827	33,547	33,337	33,044	32,671	28,684
Industrial / Commercial	3,442	3,404	3,395	3,369	3,399	2,945
Total Retail Customers	37,269	36,951	36,732	36,413	36,070	31,629
Retail Sales: (ccf)						
Residential	2,931,422	2,817,200	3,007,600	3,070,783	3,180,064	2,829,508
Industrial / Commercial	2,893,886	2,800,228	2,877,666	2,995,159	3,189,389	2,880,907
Total Retail Sales (ccf)	5,825,308	5,617,428	5,885,266	6,065,942	6,369,453	5,710,415
Retail Revenue:						
Residential	\$4,290,475	\$4,170,552	\$4,202,344	\$4,221,429	\$4,257,801	\$3,003,346
Industrial / Commercial	2,741,479	2,672,797	2,680,653	2,750,233	2,865,348	2,049,770
Public Fire Protection	549,014	545,114	541,544	536,193	528,748	324,105
Total Retail Revenue	\$7,580,968	\$7,388,463	\$7,424,541	\$7,507,855	\$7,651,897	\$5,377,221
Total Pumped (billion gallons)	4.5	4.5	4.7	4.8	5.1	4.6
Year End Restricted / Unrestricted Cash & Investment Balance	\$6,536,257	\$6,921,137	\$5,869,010	\$5,332,076	\$3,843,521	\$2,266,570

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**, *Project Manager, Facilities Engineering Manager, IBM*
Mark Browning, **Board Member**, *Project Manager, Facilities Project Services, Mayo Clinic*
Roger Stahl, **Board Member**, *Owner and Attorney, RMS Law Firm, PLLC*
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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Utility **Board**



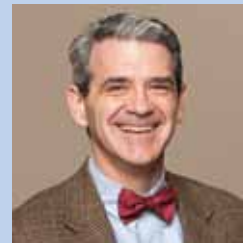
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Mayo Clinic*



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