

Synergy



Rochester Public Utilities
Annual Report 2004

About Rochester Public Utilities

Rochester Public Utilities (RPU) is a municipal utility serving Rochester, the third-largest city in Minnesota. Rochester is a vibrant, diverse, rapidly growing community of an estimated 95,000 residents in the southeastern corner of the Land of 10,000 Lakes. RPU offers electricity, water, and related products and services.

RPU is the largest municipal electric utility in Minnesota with more than 44,000 customers. The electric utility, founded in 1894, was purchased by the city in 1906. RPU's water utility serves nearly 34,000 customers. Founded privately in 1887, the water system became a city utility in 1916.

RPU owns and operates generation totaling 183 megawatts (MW), more than half of which is contracted for sale to a wholesale power agency in Minnesota. RPU purchases wholesale power, up to 216 MW, from Southeastern Minnesota Municipal Power Agency. RPU's 183 MW consist

of 100 MW of coal-fired generation, 80 MW of natural-gas-fired generation, and three MW of hydroelectric power. Peak energy demand in 2004 was 248 MW.

The water distribution system in Rochester consists of 30 deep ground-water wells and 18 storage facilities. Average daily pumpage in 2004 was 12.7 million gallons, while daily peak pumpage was 21.1 million gallons. Total storage capacity is 12.23 million gallons.

For over 110 years, RPU has provided quality, reliable electric and water service to its citizens-owners. Innovations in recent years include offering wind power for purchase, studying the wind resource in Rochester, investigating the potential of broad band over power lines (BPL), and researching alternative energy sources such as fuel cells and photovoltaic applications.

Photo by Jerry Olson



Table of Contents

2004 ANNUAL REPORT

From Management	4
Infrastructure Planning	6
Closer to Our Customers	7
Creative Solutions	8
Serving Our Dynamic City	10

2004 FINANCIAL STATEMENTS

Management's Discussion & Analysis	12
Consolidated Statements of Revenues, Expenses and Changes in Net Assets	20
Income by Segments of Business	21
Consolidated Statements of Net Assets	22
Consolidated Statements of Cash Flows	23
Notes to Consolidated Financial Statements	24
Report of Independent Auditors	28
Operating and Financial Statistics	29
General Information	30

From Management

Synergy: *The combined action of two or more substances or agencies to achieve an effect greater than that of which each is individually capable* (Webster's Riverside Edition II).

What better place to witness **synergy** than at our own local municipal electric utility? In 2004, individuals worked within crews and teams, within departments, within divisions to again provide our citizen-owners in Rochester some of the highest quality, most reliable and safe electric and water service available. To serve our city of 95,000, it takes not just one person or one department, but the seamless interaction of many.

Today, it is critical that we strive for innovation, new products and new value-added services as we work with customers who expect more for their money. Rochester is now the third-largest city in Minnesota, growing at an average rate of three percent per year. Population growth is expected to continue at this pace or better, and we must be prepared to serve all of our customers as their demands increase.

RPU's electric reliability remained above 99.99 percent in 2004, as it has for many years. Water system availability at year-end was well above 99.99 percent. This is the second-highest availability ever, second only to 2002. Continuing to deliver quality and reliability is important to the success of Rochester's economy and to our major customers, including Mayo Clinic and IBM Corp.'s Rochester location. IBM Rochester in 2004 manufactured the fastest supercomputer in the world – BlueGene/L. Mayo Clinic, the world renowned medical facility, brings millions of dollars to our southeast Minnesota economy through job creation and medical services for our residents and visitors alike.

Electric utility sales increased only slightly (0.55 percent) from 2003. Water utility retail sales were down 7.6 percent due to a cool, wet summer.

On the other hand, the number of electric and water customers increased by 2.7 percent and 3.2 percent, respectively. The electric peak demand for the year was set on July 21 at 248 megawatts (MW). Record demand was set in 2003 at 262 MW. Water peak pumpage, at 21.1 million gallons, was set on July 2, 2004. Record pumpage also occurred in 2003 at 29.3 million gallons.

RPU Synergy: Employees worked within crews and teams, within departments, and within divisions to provide our citizen-owners some of the highest quality, and most reliable, electricity and water available.

In planning for the future, we commissioned several studies and reports designed to evaluate economical and environmentally sound ways to serve our customers for the next 20 years. Infrastructure planning is a central piece of the initiative that actually began in 2003. This three-phase study includes identifying current electric demand, projecting future demand, and then recommending various ways to meet our future needs. The recommendations will include renewable and alternative energies, as well as conservation of our existing resources. This initiative also considers environmental issues and impending rules and regulations. It will suggest ways to extend the life of our current generation assets in an environmentally acceptable manner and propose future generation solutions. The final report, with recommendations, will be presented to the utility board in 2005.

In 2004, we completed Part 1 of our Wellhead Protection Plan as required by the Minnesota Department of Health. Part 1 included delineations of the Wellhead Protection Area and the Drinking Water Supply Management Areas. It also will make recommendations for addressing the vulnerabilities.

The MinnElecTrans state transmission planning process is an ongoing initiative in which we participate annually. The need for additional transmission to serve Rochester becomes apparent as early as 2008 or 2009. We are currently studying several viable options for transmission lines into Rochester, in an effort to strengthen our reliability as demand for electricity grows.

Since RPU is owned by our customers, we launched several initiatives to insure that we remain open and accessible. Throughout 2004 we engaged in open dialogue with stakeholders to identify the best solutions for all customers. Public meetings were held during the power supply planning and the annual transmission planning processes. In addition to public informational meetings, we created a task force to tackle questions regarding the infrastructure plan. Twelve community members, representing customer segments and industry partnerships, met on several occasions to learn about the challenges facing Rochester and to discuss resulting recommendations for moving forward with power supply planning for our community.

In the financial arena, RPU became a founding member of the Minnesota Consortium of Municipal Utilities (MCMU), an organization spearheaded by Minnesota Municipal Utilities Association (MMUA). MCMU offers participating utilities access to various borrowing alternatives, such as variable rate debt, as an additional financial portfolio resource.

Internally, we are also looking to the future. In 2004, we restructured our organization into five key functional areas. This change allows us to focus on efficiency improvements and alignment of responsibilities, which will aid us



in our approach of being a customer-focused organization.



John Hunziker

As we move forward, we recognize for his dedication a well known utility board and Rochester city council member: John Hunziker. Mr. Hunziker served on the Rochester city council from 1984-2004, and as its president from 1994-2004. He joined the utility board as city council liaison in 1999 and served through 2004. We thank Mr. Hunziker for his service to the utility board through years of significant growth and expansion.

The incoming city council president, Dennis Hanson, who has served on the city council since 1998, will now join the utility board as the city council liaison.

In closing, we invite you to review the 2004 Rochester Public Utilities Annual Report: *Synergy*. You will find information on business



Larry Koshire and Richard Landwehr

performance, value-added programs, renewable and conservation activity, employee endeavors, and financial performance. We thank RPU employees for their continued focus on safety and for providing great service to our customers.

Sincerely,

Larry J. Koshire *Richard L. Landwehr*

Larry Koshire
General Manager

Richard Landwehr
Utility Board
President

Infrastructure Planning

Rochester continued to grow rapidly in 2004. As we move forward, we must determine the “best” ways to serve our customers now and in the future. Finding the “best” way involves balancing interests of all stakeholders and considering economic and environmental implications. We strive to provide the lowest possible cost utility services while, at the same time, being environmentally responsible.

POWER SUPPLY

Our community is projected to continue steady growth into the foreseeable future, and we must be prepared to serve new and existing customers. To find the best ways to do this, we embarked on creating a 20-year infrastructure plan in late 2003. This includes a major power supply study that will wrap up in 2005.

The study, sparked in part by concerned community response to our steam sale project from Silver Lake Power Plant (SLP), consists of three phases. Phase 1, completed and presented in a public meeting in April, was a baseline report on current generation and what type and magnitude of traditional generation would be required to meet our city's future needs. The second phase, completed during the remainder of 2004, involved researching how conservation and renewable efforts could influence the need for the generation suggestions put forth in Phase 1. Phase 3 will be completed in early 2005, and the entire study will again be presented to the public.

In addition to determining how we will secure electricity to serve our customers, we must ensure reliability of our system with improved transmission. This is not a unique challenge, as utilities around the country are

dealing with transmission concerns. For the past two years, RPU has participated in MinnElecTrans, a coordinated statewide transmission planning process in which transmission owning utilities are required to participate. MinnElecTrans publishes the Minnesota Biennial Transmission Project Report, which documents the coordinated transmission plan by regional zones. The plan is a result of the State's concern for transmission adequacy and reliability. Each zone also must hold an annual public meeting to inform and gain public input. The Southeast Zone meeting was hosted at RPU in October. The result of this process is a multi-utility project plan for transmission system upgrades and reliability improvements that will be studied, promoted, and built in our region and throughout the state.

Photo by Jerry Olson



Closer to Our Customers

As a utility, we have the obligation to serve those in our service area with water and electric utility products. As a municipal utility, we must listen and respond quickly to customer concerns. As a local utility, we're right here, we live here, we're the friends and neighbors. And people expect a little more from their friends and neighbors.

And, as business changes and customer expectations and demands rise, we must be ready to meet and exceed expectations. That's why we restructured our senior management team and some reporting relationships, announced July 1. Previously, directors of administration and operations reported to the general manager. Now, five directors report to the general manager in the areas of core services, corporate services, customer relations, field services, and power resources.

These changes make RPU a "flatter" organization. In other words, there are less steps between line employees and top management. The idea is that employees are more empowered to make decisions regarding customer issues because they have less levels above them.

Following restructuring, the utility embarked on an ambitious process review to identify areas of possible efficiency improvements. At the end of the year, new processes in place and functioning included new offering development, internal communications, and budgeting.

Becoming closer to our customers means doing the obvious, too, like participating in or hosting community events.



In 2004, we hosted Rochester's second Arbor Day Event, with festivities downtown at Peace Plaza and a special ceremony at Gage Elementary. At Peace Plaza, lunchtime visitors were treated to lunch, music, informational displays, and free trees and seedlings from Jim Whiting's and the Minnesota Department of Natural Resources (DNR). RPU is also a major underwriter of Rochester NeighborWoods, an initiative to improve and increase urban forestry in Rochester.

Local events RPU participated in include the RAB Home Show, Rochester on Tour at the Capitol, Rochesterfest Parade, and the county fair. We also have employees who regularly participate in Meals on Wheels, the United Way, and other pursuits to better our community.



Creative Solutions

While our core business is providing electricity and water, we also strive to help customers recognize the best value from those products. This involves creating value-added products and services and developing creative solutions to customer challenges.

INDUSTRIAL CUSTOMERS

Construction started this year on a project several years in the making; the steam sale project. After several years in the permitting and appeals processes, RPU could finally begin construction on this project that will supply steam to Mayo Clinic for heating and other uses. The air quality construction permit was granted in June of 2003, but an appeal by a Minnesota concerned citizens group delayed kick-off until late 2004. Steam is scheduled to flow by the 2005 fall heating season.

This project is a creative solution to a customer need, and planning actually began more than five years ago. RPU staff worked with Mayo Clinic to determine a way RPU could supply unused steam capacity to the clinic to provide a steam and electricity solution for the north end of the downtown Rochester campus. There will be no cost to RPU customers from the project because all costs are paid for up-front by Mayo or recovered through the steam rate.

Another creative solution to meet customer needs went through planning and design in 2004. This was for another large customer – IBM Corp.'s Rochester location. The utility and IBM worked together to design a project that would improve reliability, or “harden,” the IBM site and also provide emergency generation for RPU. Two, 2-MW generators are scheduled for installation on the IBM site in the first quarter of 2005. RPU will own the generators, and IBM provides the site. Engineering costs were shared.

RESIDENTIAL CUSTOMERS

It's not only the largest customers we're committed to serving. In 2004, a very innovative project took shape on Ray Bills and Coralee Grebe's roof as they began co-generating electricity from 14 photovoltaic panels. Rated at 185 watts each, the system has a maximum hourly output of 2.59 kilowatts (kW).

The panels convert 13.3 percent of available light into electricity, so the estimated annual output in Rochester is 3,074 kilowatt-hours (kWh). Since April 13, 2004, the system has produced 1,787 kWh. During the period, the Bills-Grebes sold 1,228 kWh to RPU.

By law, utilities are required to interconnect with distributed renewable systems. RPU went beyond the requirement. We were active in the installation process, and continue to be involved in the research aspects of the system. Studying photovoltaic technology will be a great complement to our participation in evaluating the feasibility of distributed generation, which includes fuel cells and wind power.

RPU's notable creative solutions include:

- Steam Sale Project
- IBM Generator Site
- Photovoltaic Panel Installation
- Broad Band Over Power Lines Pilot
- Honda Civic Hybrid in RPU Fleet
- Continued Conserve & Save Programs

TECHNOLOGY

We also began exploring a new and exciting technology by testing broad band over power lines (BPL). BPL allows data, and possibly voice and video, to travel over power lines. This technology could offer great benefits for the utility by creating a new revenue stream by leasing power lines to a service provider and by giving us a direct route to communicate with customers, such as with sophisticated metering.

Research on BPL kicked off in February as we announced a business association with Hiawatha Broadband Communications, Inc., of Winona, Minn. HBC acts as service provider, and RPU provides the power lines to transmit the signal. Since July, when the testing went live, 12 customers have tested the Internet service in their homes and businesses.

Customers were pleased to participate, and found surfing the Internet to be quicker than their old dial-up modems. Concerns from the local amateur radio club about frequency

interference allowed us to forge a relationship with the group, which assisted with conducting field tests for radio frequency interference.

As the year closed, the trial was deemed a success. We started planning and evaluating a business model for commercial deployment in 2005. Approval for the next phase will most likely be sought from our governing bodies in the first quarter of 2005.

And, not only are we working on creative solutions for customers, but we're working on solutions for the utility. An addition to our fleet this year was a new Honda Civic Hybrid. It's a smart decision for the environment, and a smart decision for utility operations since it saves on gasoline costs. The 1.3-liter, 4-cylinder, automatic Civic has a mileage rating of 48 city, 47 highway. It emits less than 0.45 pounds of CO₂ per mile. Gasoline emits 44 pounds or more per mile.

CONSERVATION PROGRAMS

Conserve & Save is an incentive and education program that promotes the purchase of ENERGY STAR® products for energy efficiency. Conserve & Save is a joint effort of Austin, Owatonna, and Rochester Public Utilities. Conserve & Save totaled 9,791,355 kWh in energy savings in 2004. The associated demand reduction was 7,173 kW. RPU budgets approximately \$1.2 million per year in Conservation Improvement Plan (CIP) money.

Through Conserve & Save, RPU promoted the Environmental Protection Agency's (EPA) annual "Change a Light, Change the World" campaign. The campaign occurs every year in October. This year, we partnered with local Ace Hardware stores to offer customers instant, in-store rebates on compact fluorescent lamps (CFLs), which meant the customer received the bulbs for free. Nearly 50,000 CFLs entered the market during that promotion!

Also during "Change a Light, Change the World," we participated in the Teen Room Renovation at the local Boys & Girls Club. The Club moved into the former Holmes Elementary building in January 2003. The

building needed repairs to be able to host all planned club programming. By working with the Rochester Area Builders (RAB) and its members, the Boys & Girls Club has another updated area for members to enjoy. The Teen Room features a reproduction of a malt shop, including a lighted counter and booth seating. The Club's teen members will enjoy this fun room for social activities.

As an RAB associate member and the local electric utility, RPU retrofitted the Teen Room with energy-efficient lighting. The new fixtures will save 1,029 watts per year and result in \$150 annual energy savings. The fluorescent fixtures that were replaced were 29, two-lamp T12 fixtures. The new, energy-efficient ENERGY STAR fixtures are 12, four-lamp T8 fixtures. The fixtures were donated by GE Lighting and Lithonia Lighting.

An important part of program management is always evaluation. During 2004, we performed an "end-use" survey to find out what kinds of products are actually being used in the homes and businesses in our cities. Not only would this survey help us determine which programs are effective, but also which programs have been so successful that

they could be discontinued to make way for new programs. This resulted in the beginning of "Next Level" planning. The "Next Level" is a plan that all three utilities (Austin, Owatonna, and Rochester) are working on to advance conservation programming to another level beyond rebates. This plan will focus on developing more creative solutions that will help our customers more efficiently manage their energy use.



File Photo



Photo by Jerry Olson

Serving Our Dynamic City

Over the past year, our city has continued the strong growth trend of the past several years, presenting both opportunities and challenges for our utilities. Growth brings promise of economic stability and prosperity, sometimes strains resources, and always challenges us to creatively reach a goal.

The Highway 52 reconstruction project, also known as Roc52, will help to meet our city's future transportation needs. The road construction project began in early 2003 and is expected to last through 2006. In the end, 12 miles of Highway 52 through Rochester will be widened to three lanes from two, new interchanges and bridges will be added, and new sound walls will be erected in strategic places. RPU, as the local utility, relocated both electric and water utilities for the project. Some relocations were reimbursed by the Minnesota Department of Transportation while others were the responsibility of the utility when our facilities were located in rights-of-way.

In addition to projects that directly benefit citizens of Rochester, like road improvements, we are proud to support businesses that are the backbone of our city. An example is IBM Corp.'s Rochester site, where in 2004 the company unveiled the world's fastest supercomputer.

Dubbed "BlueGene/L," this machine can perform 70.72 trillion operations per second. We are proud to be the electric provider for the company that has accomplished a feat such as this – one that is receiving world-wide attention.

In 2004, RPU employees installed a record 1,186 electric meters and 1,035 water meters. This included installations to 1,489 lots in 46 new subdivisions!

Throughout 2004, RPU employees worked diligently to keep up with the increasing demand for electric and water services in Rochester. Single-family dwelling permits issued totaled 962 permits, up seven percent from 2003. Building permits overall issued in the city ended down just 22 permits from last year, at 4,115. The total value of these permits was \$332 million, up nine percent from 2003.

To put this in perspective: employees installed 1,186 electric meters and 1,035 water meters. This included installations to 1,489 lots in 46 new subdivisions. Both are new records.

Photo by Jerry Olson





Synergy

2004
Financial
Statements



Management's 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, 2004. 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.

Photo by Jerry Olson



OVERVIEW OF THE FINANCIAL STATEMENTS

This section of the annual report consists of basic financial statements and the notes to the financial statements.

Basic 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 the consolidated financial statements provide additional information that is essential to a full understanding of the figures provided in the basic financial statements.

ELECTRIC UTILITY HIGHLIGHTS

- Due to the City of Rochester's continued growth, 1,186 new electric customers were added in 2004.
- The cool summer weather had a negative impact on revenues and demand. Retail kilowatt-hour sales were less than expected, with only a slight increase from 2003, while the annual peak was 5% lower than in 2003.
- A rate increase of 3.0% was approved by the Utility Board in December 2003, and went into effect January 2004.
- Rates for power purchased from SMMPA (Southern Minnesota Municipal Power Agency) remained flat. Purchased power costs represented 59.6% of operating expenses for 2004.
- The cost to RPU of providing health insurance coverage to its employees increased 25% over 2003.
- RPU's bonds continue to be rated at Aa3 (Moody's), and A+ (Fitch).
- The Electric Utility transferred approximately \$7 million to the City's general fund in the form of in-lieu-of-tax payments.
- In 2004, RPU teamed up with Hiawatha Broadband Communications to test a new technology called broadband over power lines (BPL).

WATER UTILITY HIGHLIGHTS

- Due to the City of Rochester's continued growth, 1,035 new water customers were added in 2004.
- Retail water sales (ccf) were down 7.6% in 2004 due primarily to the wet summer. Rainfall for the summer months (May - September) was almost 46% above average.
- A rate increase of 4.0% was approved by the Board in December 2003, and went into effect January 2004.
- The Water Utility transferred approximately \$322,000 to the City's general fund in the form of in-lieu-of-tax payments.

Photo by Jerry Olson



Management's Discussion & Analysis (continued)

FINANCIAL ANALYSIS – ELECTRIC UTILITY

The following discussion provides analysis of the 2004 and 2003 comparative financial information provided in the following table.

Condensed Financial Information - Electric Utility December 31, 2004 and 2003 (In millions)

Statement of Revenues, Expenses, & Changes in Net Assets

	2004	2003	Change
Operating Revenues	\$ 102.3	\$ 99.1	\$ 3.2
Operating Expenses	90.2	88.1	2.1
Operating Income	12.1	11.0	1.1

Transfers Out

(In-Lieu-Of-Tax Payments)	(7.0)	(6.8)	0.2
Other Income & Expense	1.3	0.9	0.4
Interest Charges	(2.2)	(2.3)	(0.1)
Capital Contributions	0.4	1.2	(0.8)
Change in Net Assets	4.6	4.0	0.6

Net Assets-Beginning of Year	102.3	98.3	4.0
Net Assets-End of Year \$	<u>106.9</u>	<u>\$ 102.3</u>	<u>\$ 4.6</u>

Statement of Net Assets

	2004	2003	Change
Cash	\$ 15.5	\$ 12.0	\$ 3.5
Other Current Assets	15.5	15.7	(0.2)
Capital Assets, Net	128.4	124.9	3.5
Other Noncurrent Assets	4.5	7.4	(2.9)
Total Assets	163.9	160.0	3.9

Current Liabilities	11.7	11.1	0.6
Long-Term Debt	43.4	44.7	(1.3)
Other Long-Term Liabilities	1.9	1.9	-
Total Liabilities	57.0	57.7	(0.7)

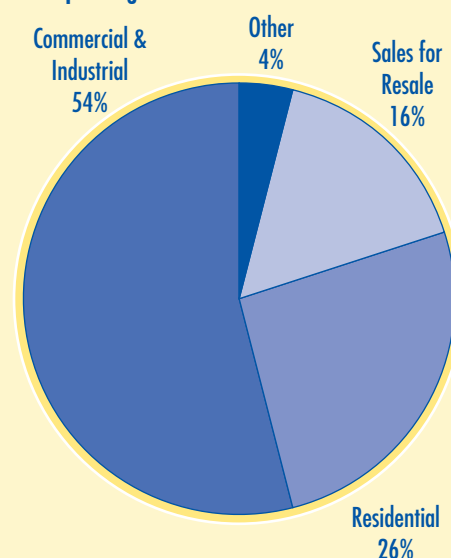
Invested in Capital Assets,

Net of Related Debt	87.2	85.4	1.8
Restricted	0.2	0.2	-
Unrestricted	19.5	16.7	2.8
Net Assets	<u>\$ 106.9</u>	<u>\$ 102.3</u>	<u>\$ 4.6</u>

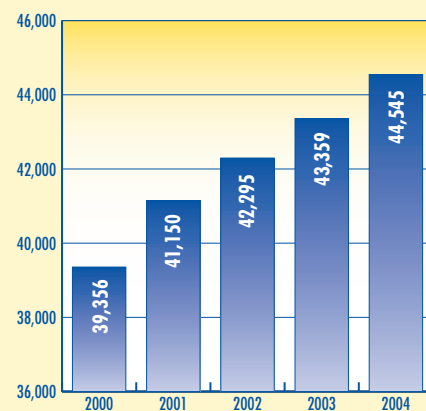
Operating Revenues

Operating revenues increased \$3.2 million (3.2%) in 2004. Much of this was due to a rate increase of 3.0%. The rate increase was partially offset by lower than expected retail and wholesale sales, due mainly to a cool summer.

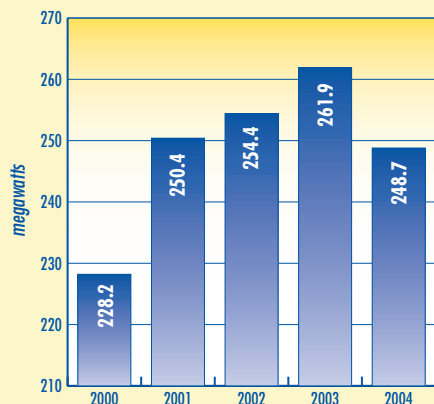
Electric Operating Revenues



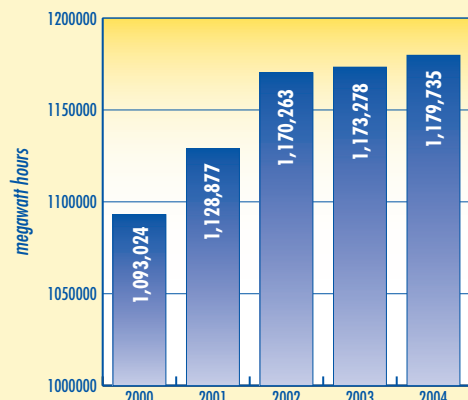
Number of Electric Customers



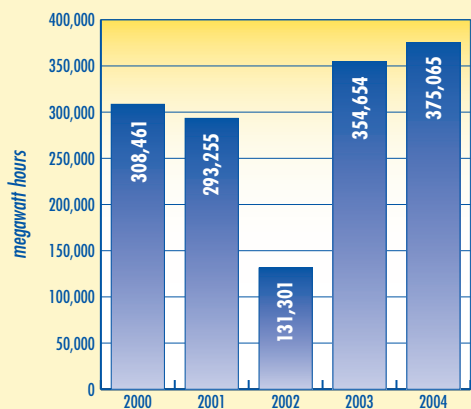
Electric Peaks



Electric Retail Sales



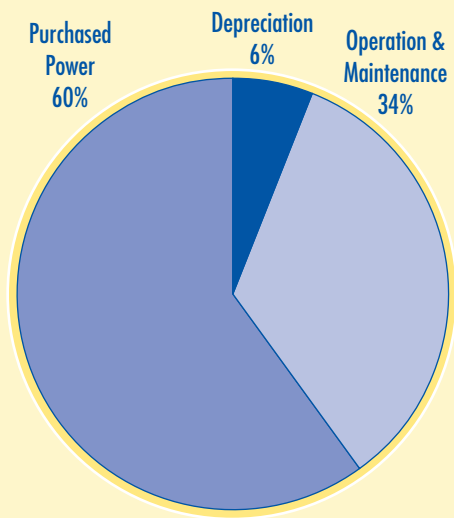
Wholesale Sales



Operating Expenses

Operating expenses increased \$2.1 million (2.4%) in 2004. Increases in fuel purchases, depreciation, and health insurance costs were offset by a slight decrease in purchased power costs due to the cool summer. The primary driver of operating expenses for the Electric Utility continues to be purchases of power from SMMPA, which comprised 60% of total Utility 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 depressed kilowatt-hour sales because of cool weather, in-lieu-of-tax payments to the City increased by only \$170,000.

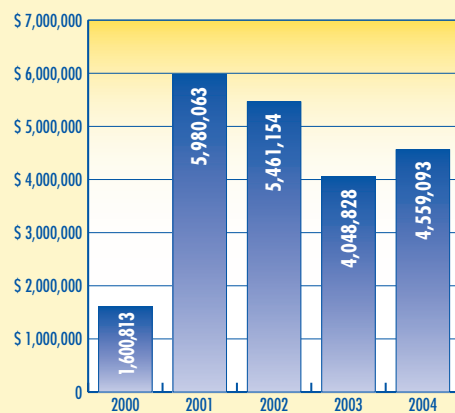
Other Income and Expense

Other income increased \$.4 million (44%) in 2004. This was primarily due to the gain recognized on sales of excess SO₂ allowances that are provided each year to the Electric Utility by the federal government at no cost.

Change in Net Assets

The increase in net assets for 2004 was \$4.6 million, \$.6 million (15%) higher than in 2003. This is due to the gain on the sales of excess SO₂ allowances and the rate increase of 3% effective January 2004.

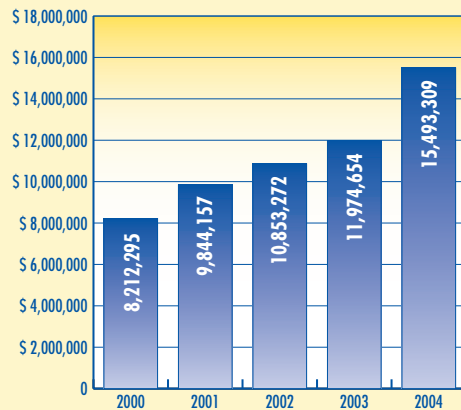
Change in Net Assets



Cash and Other Assets

The ending cash balance for 2004 was \$15.5 million, \$3.5 million higher than at the end of 2003. This is primarily due to the delay in the Mayo Steam project, which was budgeted to be completed in 2004, but did not get final approval from the EPA until September 2004.

Unrestricted Cash – Electric



Management's Discussion & Analysis (continued)

Other current assets for 2004 were \$15.5 million, \$135,000 lower than at the end of 2003. These consisted of accounts receivable, inventory, and accrued revenues.

Other noncurrent assets decreased by \$2.9 million due to the depletion of the construction fund in 2004.

Liabilities

Current liabilities increased \$.6 million in 2004, primarily due to increased accounts payable related to the Mayo steam project at the end of 2004.

Net Assets

Net assets invested in capital assets, net of related debt, increased \$1.8 million. This increase reflects additions to capital assets, and a decrease in outstanding debt. Capital expenditures are funded through rate-based revenues, fees from customers, and debt proceeds.

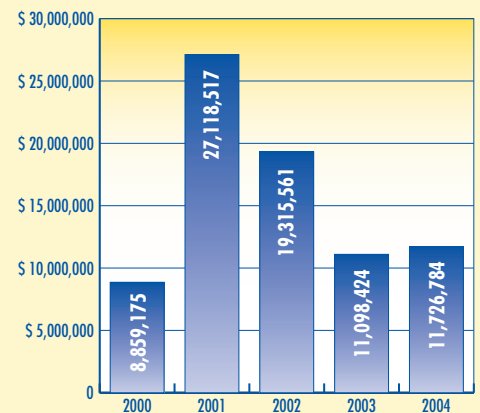
Restricted net assets remained unchanged at \$242,000. This represents resources that are subject to external restrictions, such as bond covenants or third-party contractual agreements. Specifically, restricted net assets for the Electric Utility consist of amounts placed in escrow for future acquisition of service territory from People's Cooperative Services. See Note 4 for additional details regarding this amount.

Unrestricted net assets are not subject to any constraints established by debt covenants or other legal requirements. In 2004, unrestricted net assets increased \$2.8 million due to the results of operations.

CAPITAL ASSETS

At December 31, 2004, the Electric Utility had \$128.4 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, electric transmission and distribution lines, buildings and equipment. Capital assets increased \$7.7 million in 2004, reflecting investments in the distribution and transmission systems, as well as construction associated with the growth of the city and general facilities of the Electric Utility. This increase in capital assets was partially offset by a \$4.2 million increase in accumulated depreciation. Additional details regarding the Utility's total assets (electric and water) may be found in Note 6. Capital expenditures increased slightly in 2004, although not as much as expected due to delays in two major projects, the Mayo Steam project and the IBM diesel generators.

Capital and Major Maintenance Expenditures



LONG-TERM DEBT

At the end of 2004, the Utility had \$44.7 million in revenue bonds outstanding. No new debt was issued during the year, and \$1.3 million was retired in 2004. The Utility maintains an Aa3 bond rating from Moody's, and an A+ bond rating from Fitch on its revenue bonds. Additional details regarding the Utility's long-term debt may be found in Note 5.

FINANCIAL ANALYSIS – WATER UTILITY

The following discussion provides analysis of the 2004 and 2003 comparative financial information provided in the following table.

Condensed Financial Information - Water Utility

December 31, 2004 and 2003

(In millions)

Statement of Revenues, Expenses, & Changes in Net Assets

	2004	2003	Change
Operating Revenues	\$ 6.5	\$ 6.4	\$ 0.1
Operating Expenses	5.7	5.4	0.3
Operating Income	0.8	1.0	(0.2)

Transfers Out

(In-Lieu-Of-Tax Payments)	(0.3)	(0.3)	-
Other Income & Expense	(0.03)	0.05	(0.08)
Capital Contributions	9.2	43.5	(34.3)
Change in Net Assets	9.6	44.3	(34.7)

Net Assets-Beginning of Year	64.8	20.5	44.3
------------------------------	------	------	------

Net Assets-End of Year	\$ 74.4	\$ 64.8	\$ 9.6
-------------------------------	----------------	----------------	---------------

Statement of Net Assets

	2004	2003	Change
Cash	\$ 1.7	\$ 2.0	\$ (0.3)
Other Current Assets	0.9	0.9	-
Capital Assets, Net	73.1	63.0	10.1
Total Assets	75.7	65.9	9.8

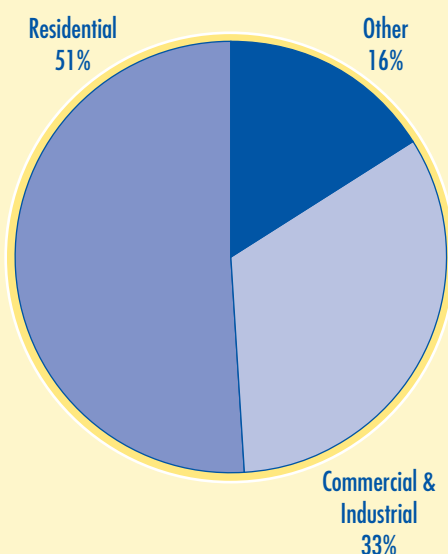
Current Liabilities	1.2	1.1	0.1
Other Long-Term Liabilities	0.1	0.1	-
Total Liabilities	1.3	1.2	0.1

Invested in Capital Assets	73.1	63.0	10.1
Unrestricted	1.3	1.8	(0.5)
Net Assets	\$ 74.4	\$ 64.8	\$ 9.6

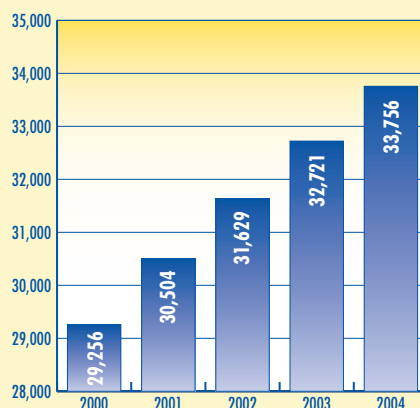
Operating Revenues

Operating revenues increased \$110,000 (1.7%) in 2004. Some of this was due to a rate increase of 4.0%, although ccf sales were down due to the wet summer. Antenna revenues also increased \$43,000, and revenues from the Service Assured program increased \$21,000.

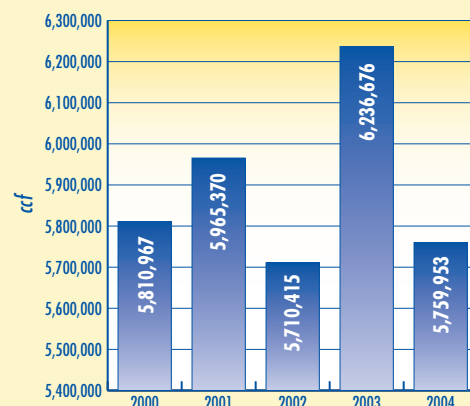
Water Operating Revenues



Number of Water Customers



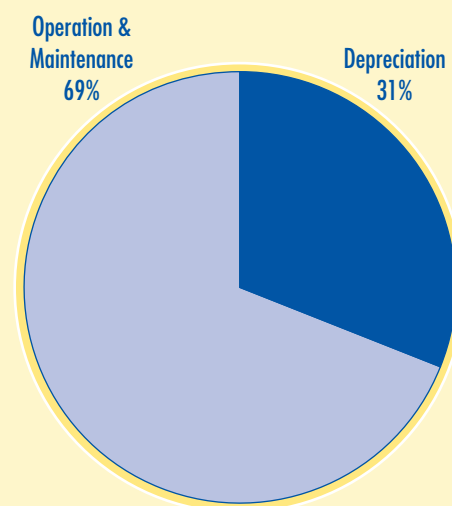
Water Retail Sales



Operating Expenses

Operating expenses increased by \$350,000 (6.0%) in 2004. This was primarily due to a large increase in depreciation from the \$43.5 million of contributed capital assets added at the end of 2003.

Water Operating Expenses



Management's Discussion & Analysis *(continued)*

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 2004, in-lieu-of-tax payments to the City decreased by approximately \$17,000.

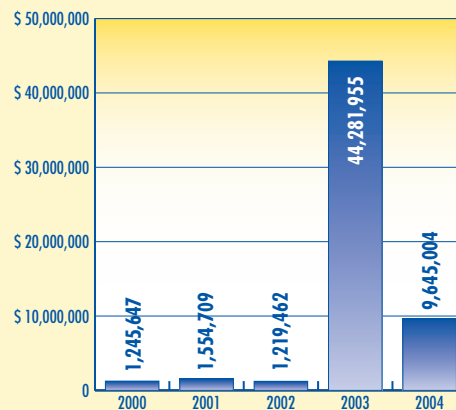
Capital Contributions

Capital contributions decreased \$34.3 million in 2004. These are assets, primarily water mains and fire hydrants, which are contributed to the Water Utility from both the City and from developers. These assets are valued using a costing database that estimates the appropriate construction costs associated with these assets. In 2003, the City of Rochester contributed all water infrastructure assets to RPU.

Change in Net Assets

The increase in net assets for 2004 was \$9.6 million, \$34.7 million lower than in 2003. This is primarily due to the decrease in reported capital contributions in 2004.

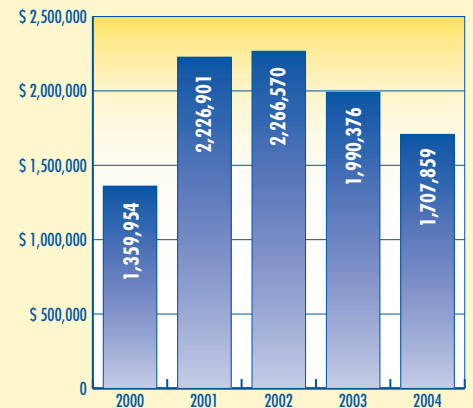
Change in Net Assets



Cash and Other Assets

The ending cash balance for 2004 was \$1.7 million, \$280,000 lower than at the end of 2003. This was primarily due to spending on capital projects.

Unrestricted Cash – Water



There was no significant change in other current assets in 2004.

Liabilities

Current liabilities increased \$65,000 in 2004, primarily due to increased accounts payable at the end of 2004 related to capital projects such as the Highways 52 and 63 projects.

Net Assets

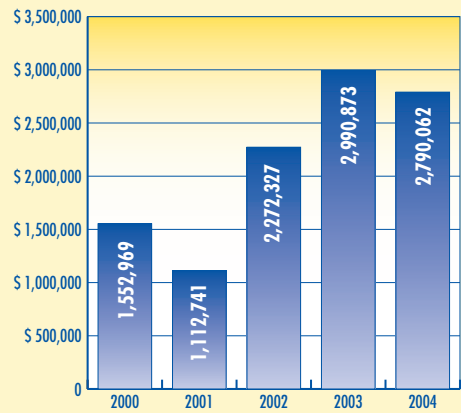
Net assets invested in capital assets increased \$10.1 million. This increase reflects the increase in net capital assets. Capital expenditures for the Water Utility are funded through rate-based revenues and fees from customers.

Unrestricted net assets are not subject to any constraints established by debt covenants or other legal requirements. In 2004, unrestricted net assets decreased \$.5 million due to the results of operations.

CAPITAL ASSETS

At December 31, 2004, the Water Utility had \$73.1 million invested in a broad range of utility capital assets, including 12 water towers, 30 wells, water mains, storage and pump station facilities, buildings, and equipment. Capital assets increased \$11.5 million in 2004, 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 \$1.4 million increase in accumulated depreciation. Additional details regarding the Utility's total assets (electric and water) may be found in Note 6. Capital expenditures decreased slightly in 2004. One of the major components of capital spending in 2004 was Highways 52 and 63 due to the ongoing construction.

Capital and Major Maintenance Expenditures



MISCELLANEOUS INFORMATION

ECONOMIC FACTORS

The City Council has approved electric rate increases two out of the last three years, and water rate increases for two consecutive years. These overall increases of 3.0% for 2002 and 2004 for the Electric Utility, and 4.0% for 2003 and 2004 for the Water Utility will help strengthen RPU's financial stability by meeting the expected increased costs to operate each Utility, improve system reliability, and build liquidity by increasing cash reserves.

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.

SIGNIFICANT SUBSEQUENT EVENTS

In December of 2004 the Utility Board authorized borrowing approximately \$5 million through a consortium of utilities at a variable interest rate. The closing on this loan occurred in March of 2005. This money will be used by the Electric Utility during 2005 to improve the distribution system.

REQUESTS FOR INFORMATION

The basic financial statements, notes, and management's 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 East River Road 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.

2004 Financial Statements

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

YEARS ENDED DECEMBER 31

	2004	2003
Operating Revenues:		
Electric	\$102,339,632	\$99,090,742
Water	6,475,669	6,368,057
Total Operating Revenues	108,815,301	105,458,799
Operating Expenses:		
Purchased Power	53,787,320	53,999,389
Operations and Maintenance	34,432,299	33,246,051
Depreciation	7,714,913	6,192,313
Total Operating Expenses	95,934,532	93,437,753
Operating Income	12,880,769	12,021,046
Nonoperating Income (Expenses):		
Investment Income	501,968	604,081
Interest Expense	(2,120,360)	(2,077,922)
Miscellaneous, Net	654,424	167,617
Total Nonoperating Income (Expenses)	(963,968)	(1,306,224)
Income Before Transfers/Capital Contributions	11,916,801	10,714,822
Transfers Out	(7,299,132)	(7,144,081)
Capital Contributions	9,586,428	44,760,042
Change in Net Assets	14,204,097	48,330,783
Net Assets, Beginning of Year	167,084,348	118,753,565
Net Assets, End of Year	\$181,288,445	\$167,084,348

See Notes to Consolidated Financial Statements Found on Pages 24-27

Income by Segments of Business

2004	Electric	Water	Total
Operating Revenues	\$102,339,632	\$6,475,669	\$108,815,301
Operating Expenses	90,223,040	5,711,492	95,934,532
Operating Income	12,116,592	764,177	12,880,769
Nonoperating Income (Expense)	(938,745)	(25,223)	(963,968)
Income Before Transfers/Capital Contributions	11,177,847	738,954	11,916,801
Transfers Out	(6,976,896)	(322,236)	(7,299,132)
Capital Contributions	358,142	9,228,286	9,586,428
Change in Net Assets	\$4,559,093	\$9,645,004	\$14,204,097

2003	Electric	Water	Total
Operating Revenues	\$99,090,742	\$6,368,057	\$105,458,799
Operating Expenses	88,078,566	5,359,187	93,437,753
Operating Income	11,012,176	1,008,870	12,021,046
Nonoperating Income (Expense)	(1,358,531)	52,307	(1,306,224)
Income Before Transfers/Capital Contributions	9,653,645	1,061,177	10,714,822
Transfers Out	(6,805,010)	(339,071)	(7,144,081)
Capital Contributions	1,200,193	43,559,849	44,760,042
Change in Net Assets	\$4,048,828	\$44,281,955	\$48,330,783

See Notes to Consolidated Financial Statements Found on Pages 24-27

2004 Financial Statements

(Continued)

Consolidated Statements of Net Assets

DECEMBER 31

	2004	2003
ASSETS:		
Current Assets:		
Cash and Cash Equivalents (Note 3)	\$17,201,168	\$13,965,031
Accounts Receivable and Accrued Utility Revenues	9,482,030	9,904,434
Fossil Fuel Inventory	2,515,929	2,672,762
Materials and Supplies Inventory	4,329,187	3,945,527
Other Current Assets	110,055	108,402
Total Current Assets	33,638,369	30,596,156
Non-Current Assets:		
Restricted Assets (Note 4):		
Cash and Cash Equivalents	3,517,468	6,436,953
Amounts Held in Escrow	241,608	240,591
Total Restricted Cash and Cash Equivalents	3,759,076	6,677,544
Deferred Charges:		
Unamortized Bond Issuance Costs	500,634	541,607
Other	208,595	167,180
Total Deferred Charges	709,229	708,787
Capital Assets:		
Construction Work in Progress	10,481,206	13,170,833
Land and Land Rights	2,103,301	1,994,774
Depreciable Assets, Net (Note 6)		
Electric	118,330,570	112,505,697
Water	70,538,089	60,267,682
Net Capital Assets	201,453,166	187,938,986
Total Non-Current Assets	205,921,471	195,325,317
Total Assets	\$239,559,840	\$225,921,473
LIABILITIES:		
Current Liabilities:		
Accounts Payable	\$7,440,061	\$6,595,471
Due to Other Funds	1,869,377	1,675,345
Accrued Compensated Absences	1,571,694	1,794,143
Customer Deposits	353,818	290,591
Interest Payable	181,477	185,602
Current Maturities of Long Term Debt (Note 5)	1,310,000	1,265,000
Deferred Credits	176,479	364,776
Total Current Liabilities	12,902,906	12,170,928
Non-Current Liabilities:		
Accrued Compensated Absences	901,369	824,302
Accrued Claims	149,000	160,000
Revenue Bonds Payable		
(net of unamortized discount) (Note 5)	43,397,806	44,725,161
Unearned Lease Revenues	920,314	956,734
Total Non-Current Liabilities	45,368,489	46,666,197
Commitments and Contingencies (Note 10)		
Total Liabilities	\$58,271,395	\$58,837,125
NET ASSETS:		
Invested in Capital Assets, Net of Related Debt	\$160,262,828	\$148,385,779
Restricted (Note 4)	241,608	240,591
Unrestricted Net Assets	20,784,009	18,457,978
Total Net Assets	\$181,288,445	\$167,084,348

See Notes to Consolidated Financial Statements Found on Pages 24-27

Consolidated Statements of Cash Flows

DECEMBER 31

	2004	2003
Cash Flows From Operating Activities:		
Cash Received from Customers	\$106,491,347	\$101,658,435
Cash Paid to Suppliers and Employees	(88,374,191)	(87,395,089)
Internal Activity – Payments From Other Funds	3,561,614	3,480,391
Net Cash Provided By Operating Activities	21,678,770	17,743,737
Cash Flows From Noncapital Financing Activities:		
Transfers to Other Funds	(7,262,600)	(7,152,168)
Cash Flows From Capital and Related Financing Activities:		
Capital Contributions	179,083	1,200,193
Additions to Utility Plant and Other Assets	(10,509,249)	(12,790,306)
Service Territory Acquisition	(596,357)	(1,170,977)
Payments on Bonds and Notes Payable Obligations	(3,672,295)	(3,701,372)
Net Cash (Used In) Capital and Related Financing Activities	(14,598,818)	(16,462,462)
Cash Flows From Investing Activities:		
Interest Received	500,317	714,855
Service Territory Escrow Payments	(1,017)	(2,608)
Funds Released From Service Territory Escrow		48,676
Net Cash Provided By Investing Activities	499,300	760,923
Net Increase (Decrease) in Cash and Cash Equivalents	316,652	(5,109,970)
Cash and Cash Equivalents, Beginning of Year	20,401,984	25,511,954
Cash and Cash Equivalents, End of Year	\$20,718,636	\$20,401,984
Classified As:		
Current Assets	\$17,201,168	\$13,965,031
Restricted Assets	3,517,468	6,436,953
Total Cash and Cash Equivalents, End of Year	\$20,718,636	\$20,401,984
Reconciliation of Operating Income to Net Cash Provided by Operating Activities:		
Operating Income	\$12,880,769	\$12,021,046
Adjustments to Reconcile Operating Income to Net Cash Provided by Operating Activities:		
Depreciation	7,714,913	6,192,313
Other	781,791	431,947
(Increase) Decrease In:		
Accounts Receivable and Accrued Utility Revenues	422,405	(1,084,190)
Inventories	(226,827)	(1,496,653)
Prepaid and Other Current Assets	13,242	30,470
Increase (Decrease) In:		
Accrued Liabilities and Accounts Payable	253,967	1,538,262
Customer Deposits	63,227	29,574
Unearned Lease Revenues	(36,420)	(36,421)
Other	(188,297)	117,389
Net Cash Provided by Operating Activities	\$21,678,770	\$17,743,737
Non-Cash Capital and Related Financing Activities:		
Additions to Utility Plant and Other Assets Contributed by the City's Governmental Funds	\$3,248,733	\$41,528,675
Additions to Utility Plant and Other Assets Contributed by Developers	\$6,158,612	\$2,031,174

See Notes to Consolidated Financial Statements Found on Pages 24-27

2004 Financial Statements

(Continued)

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 fund-basis financial statements as a business-type activity in conformity with accounting practices prescribed for regulated enterprises by 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.

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 a 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 one-third of their unused sick leave, after meeting certain qualifications.

Amortization of Bond Issuance Costs and Bond Discount

Bond issuance costs, bond discount and bond premium 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 2003 financial statements to conform to the 2004 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 are primarily comprised 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 \$2,995,289 and \$3,160,131 for the years ended December 31, 2004 and 2003, respectively.

Sales to the Utility's single largest customer were \$10,990,528 and \$9,704,156 in 2004 and 2003, respectively. During the year ended December 31, 2004, no other customer accounted for more than 10% of operating revenues. Sales to other funds of the City of Rochester were \$3,036,064 and \$2,855,107 for the years ended December 31, 2004 and 2003, respectively.

NOTE 3: Cash and Cash Equivalents

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

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 2004 Comprehensive Annual Financial Report by credit risk category which gives an indication of the level of credit risk assumed by the City of Rochester.

NOTE 4: Restricted Assets

Restricted Cash and Cash Equivalents

In 2002 the Electric Utility issued revenue bonds to fund improvements to the distribution system and in 2000 the Electric Utility issued revenue bonds to fund the construction of a new gas turbine generator and improvements to the Electric Utility's transmission and distribution system. Provisions of the revenue bonds require that the Electric Utility 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 \$3,517,468 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 terms of the revenue bonds, the bond proceeds, net of accrued interest, bond discount, and the reserve requirement, were deposited into a construction account to pay all construction-related costs.

Restricted Cash and Cash Equivalents are summarized as follows:

	2004	2003
Reserve Account	\$ 3,517,468	\$ 3,517,468
Construction Account	0	2,919,485
Total	\$ 3,517,468	\$ 6,436,953

Restricted Amounts Held in Escrow

In accordance with a territorial rights agreement with People's Cooperative Services, the Utility deposits funds in an escrow account managed by a fiscal agent upon annexation of areas in service territories assigned to People's Cooperative Services. Upon agreement of compensation for the transfer of the service territory rights to the Utility, the

2004 Financial Statements

(Continued)

Notes to Consolidated Financial Statements

funds in escrow are returned to the Utility. The service territory escrow fund totaled \$241,608 and \$240,591 at December 31, 2004 and 2003 respectively.

NOTE 5: Long-Term Debt

At December 31, 2004 and 2003, long-term debt consisted of the following:

	2004	2003
Revenue Bonds, Series 2002A 3.00% - 4.50%, due each December 1, through 2017	\$ 10,225,000	\$ 10,830,000
Revenue Bonds, Series 2000A, 4.75% - 5.25%, due each December 1, through 2030	34,825,000	35,485,000
Less:		
Unamortized Discount	421,524	434,150
Plus:		
Unamortized Premium	79,330	109,311
Less:		
Current Maturities	1,310,000	1,265,000
Total	\$ 43,397,806	\$ 44,725,161

The revenue bonds are secured by all funds and revenues of the Utility derived from the ownership and operation of its electric utility system. The bond issuance costs, bond discount and bond premium are amortized over the terms of the bond issues.

The annual requirements to amortize all debt outstanding as of December 31, 2004, including interest payments of \$32,475,622 are as follows:

2005	\$ 3,487,719
2006	3,491,344
2007	3,487,706
2008	3,495,393
2009	3,493,656
Thereafter	60,069,804
Total	\$ 77,525,622

NOTE 6: Capital Assets

Major classes of depreciable assets and total accumulated depreciation as of December 31, 2004 and 2003 are as follows:

	2004	2003
Intangible Plant Assets	\$ 7,387,877	\$ 6,758,947
Buildings, Structures, and Improvements	26,527,152	26,997,433
Installations, Equipment, and Fixtures	251,480,269	229,785,438
Total Depreciable Assets	285,395,298	263,541,818
Less: Accumulated Depreciation	96,526,639	90,768,439
Net Depreciable Assets	\$ 188,868,659	\$ 172,773,379

In 2004 capital assets totaling \$3,248,733 were contributed to the Utility by the City of Rochester, and \$6,158,612 were contributed to the Utility by others.

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 1,202,156,074 and 1,190,599,757 kilowatt hours totaling \$54,887,199 and \$54,923,316 from SMMPA during the years ended December 31, 2004 and 2003, respectively.

The Utility was reimbursed \$1,947,072 and \$2,050,584 for the years ended December 31, 2004 and 2003 respectively, for its share of previous SMMPA charges. These reimbursed charges are reported as offsets to purchased power costs.

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 Public Employees Retirement Fund (PERF) 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, 2004 were \$1,316,136 of which

\$672,441 was made by the Utility and \$643,695 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 PERF. That report may be obtained by writing to PERA, 60 Empire Dr. # 200, St. Paul, Minnesota, 55103-2088 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, 2004 and 2003 was \$108,273 and \$121,510, respectively. Payments under the plan for 2004 and 2003 were \$14,770 and \$17,855, respectively.

NOTE 9: Legal Matters

The Utility continues to pursue the acquisition of certain electric service rights from People's Cooperative Services, a rural utility system. At times this involves proceedings before the Minnesota Public Utilities Commission and the Minnesota courts, and negotiation of various settlement agreements with People's Cooperative Services.

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 \$225,000 per claim with a variable annual aggregate, and the workers' compensation coverage is limited to \$720,000 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. The Utility recognized an estimated liability for workers' compensation claims of \$47,000 and \$51,000 at December 31, 2004 and 2003, respectively. No actuarial studies have been performed by independent actuaries.

Power Sales Agreement

The Utility has entered into an agreement with the Minnesota Municipal Power Agency (MMPA) to sell a maximum 100 megawatts of power annually from its Silver Lake Plant to MMPA at a fixed rate. Under the terms of the agreement, the Utility is paid a fixed fee for providing the availability of generating capacity and is reimbursed for the fuel-related costs of generating power.

Activity under this agreement for the years ended December 31, 2004 and 2003 was as follows:

	2004	2003
kWh provided	363,091,000	338,148,663
Payments for availability	\$ 4,700,160	\$ 4,599,360
Reimbursed generation costs	\$ 10,726,349	\$ 9,828,970

Service Territory Settlements

In connection with the acquisitions of certain electric service rights from People's Cooperative Services (PCS), the Utility is required to make payments to PCS based upon the amount of electricity sold in specific territories over a ten-year term. The payment varies by each settlement agreement and ranges from 5.7 mills (tenths of a cent) per kWh to 14.5 mills per kWh. These commitments expire over periods from 2004 to 2012. 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, 2004 and 2003 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 are not intended to present fairly the financial position of the City of Rochester 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 fund-basis financial statements referred to above present fairly, in all material respects, the financial position of Rochester Public Utilities as of December 31, 2004 and 2003, 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 12 through 19 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, Itc.

*Smith, Schafer and Associates, Ltd.
Certified Public Accountants
February 18, 2005
Rochester, Minnesota*

Operating and Financial Statistics (unaudited)

ELECTRIC	2004	2003	2002	2001	2000	1995
Retail Customers:						
Residential	40,329	39,244	38,259	37,196	35,575	31,493
General Service	4,210	4,109	4,030	3,948	3,7751	3,341
Industrial / Commercial	2	2	2	2	2	19
Other	4	4	4	4	4	4
Total Retail Customers	44,545	43,359	42,295	41,150	39,356	34,857
Retail Sales: (kWh)						
Residential	300,108,426	304,653,325	302,755,054	281,380,914	266,869,075	233,990,667
General Service	592,690,358	601,393,595	608,230,284	588,722,985	564,982,838	311,287,665
Industrial / Commercial	270,939,006	250,347,096	243,121,084	242,412,000	245,259,867	361,809,525
Other	15,997,702	16,883,613	16,156,452	16,361,294	15,912,286	13,656,882
Total Retail Sales (kWh)	1,179,735,492	1,173,277,629	1,170,262,874	1,128,877,193	1,093,024,066	920,744,739
Retail Revenue:						
Residential	\$26,391,940	\$25,876,051	\$25,569,567	\$23,182,844	\$22,143,004	\$19,778,833
General Service	41,172,242	40,375,839	40,155,746	38,046,675	36,830,277	23,817,279
Industrial / Commercial	14,536,253	13,281,822	13,093,886	12,904,764	12,932,888	22,606,361
Other	1,756,415	1,722,054	1,650,037	1,604,468	1,580,620	1,399,546
Total Retail Revenue	\$83,856,850	\$81,255,766	\$80,469,236	\$75,738,751	\$73,486,789	\$67,602,019
Annual Peak (Megawatts)	248.7	261.9	254.4	250.4	228.2	204.5
Total kWh Generated	383,245,906	361,726,670	144,260,682	300,149,000	314,358,000	193,035,400
Total kWh Purchased	1,208,354,664	1,194,543,798	1,179,943,696	1,155,555,944	1,123,571,924	945,706,061
Year End Cash Balance	\$19,252,385	\$18,652,198	\$23,532,042	\$24,455,887	\$45,857,123	\$12,299,942
WATER	2004	2003	2002	2001	2000	1995
Retail Customers:						
Residential	30,622	29,663	28,684	27,589	26,454	22,921
Industrial / Commercial	3,134	3,058	2,945	2,915	2,802	2,619
Total Retail Customers	33,756	32,721	31,629	30,504	29,256	25,540
Retail Sales: (ccf)						
Residential	2,751,441	3,314,437	2,829,508	2,853,453	2,709,202	2,442,912
Industrial / Commercial	3,008,512	2,922,239	2,880,907	3,111,917	3,101,765	2,841,332
Total Retail Sales (ccf)	5,759,953	6,236,676	5,710,415	5,965,370	5,810,967	5,284,244
Retail Revenue:						
Residential	\$3,303,751	\$3,423,496	\$3,003,346	\$2,959,844	\$2,598,930	\$2,062,603
Industrial / Commercial	2,275,949	2,141,201	2,049,770	2,164,850	1,965,207	1,605,421
Public Fire Protection	429,228	401,055	324,105	291,665	248,790	211,946
Total Retail Revenue	\$6,008,928	\$5,965,752	\$5,377,221	\$5,416,359	\$4,812,927	\$3,879,970
Total Pumped (gallons)	4,591,078,140	5,011,304,421	4,560,177,918	4,789,401,579	4,605,549,252	4,181,573,172
Year End Cash Balance	\$1,707,859	\$1,990,376	\$2,266,570	\$2,226,901	\$1,359,954	\$1,467,357

General Information

ROCHESTER PUBLIC UTILITIES LEADERSHIP

General Manager Larry Koshire
Director, Core Services Walter Lorber
Director, Corporate Services Curt Kraft
Director, Customer Relations Jim Walters
Director, Field Services Joseph Hensel
Director, Power Resources Walter Schlink

UTILITY BOARD

Board President Richard Landwehr, Director of Business Development, Weis Builders, Inc.
Board Member Mark Utz, Attorney, Wendland, Utz, Stahl, and Mintz, Ltd.
Board Member John (Jack) Jibben, Vice Chair of Project Coordination and Campus Planning, Mayo Clinic
Board Member Susan Parker, Controller, Olmsted County Public Works
Board Member and City Council Liaison John Hunziker, Executive Director, Olmsted County History Center

ADVISORS AND CONSULTANTS

Independent Auditors Smith, Schafer and Associates, Ltd.
Bond Counsel Briggs & Morgan
Financial Advisors Springsted Public Finance Advisors

HEADQUARTERS

Rochester Public Utilities
4000 East River Road NE
Rochester, MN 55906-2813
800-778-3421
507-280-1500
www.rpu.org

General Information

ROCHESTER PUBLIC UTILITIES LEADERSHIP

General Manager

Larry Koshire

Director, Core Services – Walter Lorber

Director, Corporate Services – Curt Kraft

Director, Customer Relations – Jim Walters

Director, Field Services – Joseph Hensel

Director, Power Resources – Walter Schlink

UTILITY BOARD

Board President

Richard Landwehr

Director of Business Development

Weis Builders, Inc.

Board Member

Mark Utz

Attorney

Wendland, Utz, Stahl, and Mintz, Ltd.

Board Member

John (Jack) Jibben

Vice Chair of Project Coordination

and Campus Planning

Mayo Clinic

Board Member

Susan Parker

Controller

Olmsted County Public Works

Board Member and City Council Liaison

John Hunziker

Executive Director

Olmsted County History Center

ADVISORS AND CONSULTANTS

Independent Auditors

Smith, Schafer and

Associates, Ltd.

Bond Counsel

Briggs & Morgan

Financial Advisors

Springsted Public

Finance Advisors

HEADQUARTERS

Rochester Public Utilities

4000 East River Road NE

Rochester, MN 55906-2813

800-778-3421

507-280-1500

www.rpu.org

REPORT CREDITS

Project Manager

Julie Moenck

Copy Writer

Julie Moenck

Financial Statements

Coordinator

Mary Borgschatz

Graphic Designer

Garcia Graphics

Printer

Johnson Printing



Rochester Public Utilities
4000 East River Road NE
Rochester, MN 55906-2813
www.rpu.org



This report is printed on recycled paper
containing 30% post-consumer waste.