

2010 ANNUAL REPORT



Bridge to the Future



**Homer Electric
Association, Inc.**

A Touchstone Energy® Cooperative 

MESSAGE

FROM THE PRESIDENT & GENERAL MANAGER

It is our honor and privilege to report to the Homer Electric membership on the accomplishments of the past year and also outline the exciting challenges that await us in 2011.

The theme for this year's Annual Meeting is *Bridge to the Future*. The theme is a reflection of the HEA Board of Directors' and management's commitment to developing an energy plan that will benefit not only today's members, but also our next generation. We are confident that our *Bridge to the Future* is secure and will result in reliable, affordable power for HEA members in the coming years.



By now, most of our members know that HEA has a goal of being responsible for its own power generation needs by January 2014. This represents a monumental shift in the way HEA does business.

Since the 1960's, HEA has been a customer of Chugach Electric and has purchased power from Chugach under a series of contracts with the Anchorage-based utility. After careful consideration, the HEA Board of Directors decided our members will be better served by HEA taking care of its own power requirements and placing generation assets and associated jobs here on the

Kenai Peninsula.

The result of this decision is Independent Light. Independent Light is HEA's blueprint for a successful transition from power purchaser to power provider. Independent Light will provide us with the infrastructure needed to take care of our power generation needs beginning on January 1, 2014.

The groundwork for Independent Light has been laid over the past 12 months as engineers and designers have worked diligently on this project. Their hard work is coming to fruition now as we prepare for the actual construction of the power generation facilities.

Over the next two years, you will see work taking place at the Nikiski Generation Plant as Phase I of Independent Light comes on line. The installation of a steam turbine generator at Nikiski will increase the capacity of the plant, from 40 megawatts to 77 megawatts. The beauty of the project is that by capturing exhaust heat from the existing natural gas fired generator and producing steam, we will nearly double the output of the plant with a minimal increase in the amount of natural gas needed for fuel.

The second phase of Independent Light calls for re-installing generation at the Soldotna Plant and substation to meet reserve capacity requirements. At this time, the HEA Board has approved the purchase of one aero-derivative combustion turbine generator with a nominal capacity of up to 49 megawatts.

The Board of Directors and



Brad Janorschke, General Manager

management are extremely pleased with the progress that has been made on Independent Light, our *Bridge to the Future*!

While we move forward with Independent Light, we are keenly aware of the need to develop renewable energy in the State of Alaska. HEA has joined with four Railbelt utilities to form a new entity called the Alaska Railbelt Cooperative Transmission and Electric Company, or ARCTEC.

The goal of ARCTEC is to jointly pursue, in partnership with the State, large scale renewable energy projects that will benefit the entire Railbelt region. Whether it's a hydro project like Susitna or a geothermal facility at Mt. Spurr, the most effective way to promote these renewable energy projects is through a partnership with other utilities. The HEA Board is serious about developing renewable energy and we

believe ARCTEC is the vehicle we can use to make this happen.

Great strides have been made over the past year preparing for the start of a new era in HEA's history. The work by the HEA staff up to now has been exemplary and provides us with the utmost confidence that we will be successful in achieving our goal come January 2014.

In closing, we would like to express our sincere appreciation to all the HEA members who have contacted the Board and staff over the past year to share their opinions and offer advice. HEA is a member owned cooperative and open communication between the Board and the members is the lifeblood of the Cooperative. Thank you for all your support and we look forward to another great year working with the members of HEA!



Debbie Debnam, President

2010 YEAR IN REVIEW

Homer Electric Association, Inc. (HEA) is looking forward to the many opportunities for growth in the upcoming years. As we move away from dependence on Chugach Electric Association (CEA) to meet our wholesale power needs, the momentum and activity at the Cooperative increases. Last year at this time we were weighing important decisions about how to ensure a reliable power supply for the future. So, in 2010 we devoted a lot of resources toward making those important decisions which included designing plans for new generation as well as putting the plans into action. With new sources of generation at its disposal, your Cooperative will be positioned to have a viable, sustainable and efficient portfolio of electric generation sources when our contract with CEA expires on December 31, 2013. Preparing to do business in a new way has required many improvements and

upgrades to both our transmission and distribution systems this year.

Of equal importance, fulfilling our promise to offer superior yet affordable energy services continues to be our core mission. Rising fuel and construction costs, along with rapidly changing technologies, have provided both a challenge and an opportunity. We're proud that HEA was the first Alaskan utility to introduce Net Metering and establish guidelines for connecting small member-owned "green power" generators to the system. We remain dedicated to teaching and encouraging conservation and hosted our second annual Energy & Conservation Fairs this year. We're also using innovative technology to increase the life of underground cable and read meters remotely; all done safely and efficiently.

Read on for more details about our busy year.

BUILDING THE BRIDGE TO THE FUTURE

We are committed to becoming the wholesale power provider for our membership, starting in 2014, with the Independent Light program and have been building the foundation for this project over the past year. Preparation includes upgrades to the electric system, constructing new substations, and various system upgrades to improve reliability and ensure a solid base for a successful transition from power purchaser to power provider.

SUBSTATIONS: PROVIDING GREATER RELIABILITY & CAPACITY

Several substation projects that provide greater reliability to the Cooperative's entire service territory have been completed.

TESORO SUBSTATION: REFINERY CAPACITY INCREASE

Working in cooperation with Tesoro, a new electric power delivery substation and 115 kV transmission line was constructed and placed in service to allow increased power delivery and improve service reliability to the Tesoro Refinery in North Kenai.

The substation that previously served the refinery was first put into service in 1981 and will be retained for use as a backup. The higher capacity substation and transmission lines will help ensure reliable power delivery to the Tesoro Refinery for many years to come.



DIAMOND RIDGE SUBSTATION COMPLETION

The Diamond Ridge Substation has created another source for 24.9 kV power to the Homer grid and as a result, provides greater reliability to the area. In 2010, the 115 kV and 69 kV transmission lines were reconfigured and the 115/69 kV transformer was relocated. This substation replaces an older facility that has since been demolished.



HATFIELD SUBSTATION MAINTENANCE

With the completion of the Diamond Ridge Distribution Substation, and for the first time since energized in 1970, Homer Electric was able to take the Hatfield Substation offline to perform thorough maintenance and testing. In 2010, switches were replaced, ground grid issues were corrected, and transformers tested to ensure their continued serviceability. All necessary repairs were completed and a routine maintenance schedule has been developed.



SYSTEM IMPROVEMENTS

RESIDENTIAL AUTOMATED METER READING (AMR) COMPLETION

Last year, Homer Electric successfully completed a system-wide program to install 28,000+ single-phase automated meters in our service territory. This is a huge benefit for members, as it reduces estimated meter readings and results in fewer billing adjustments. The AMR software provides real-time meter information that can be used to help members understand their energy usage and assist with power outage restoration.

CABLE INJECTION PROJECT

In 2007, Homer Electric Association implemented an underground cable injection process for treating degrading cables on our

system. This method is both cost effective and the least disruptive. Depending on the condition of the cable, this practice can extend the life expectancy of underground cable by as much as 40 years. In addition, reliability has improved greatly as there have been zero faults (failures) on cable that has been rejuvenated through the injection process.

A significant portion of the cable injected was the feeder exits out of the Billy Thompson Substation in Soldotna. Since the beginning of the project, approximately 82,412 feet of aging underground cable has been injected, with 36,247 feet in 2010 alone. Our crews have been specially trained in this process and each year we become more efficient and are able to provide more injection footage at lower costs.

SELDOVIA SYSTEM IMPROVEMENTS

To enhance service for our members across the bay, HEA successfully completed the switch automation at Mile 6 on Jakolof Bay Road in Seldovia and installed a new transformer at the Gerry Willard Generation Plant last spring. The automation allows us to operate the switch remotely, which in turn allows more of the system to be picked up sooner by the Gerry Willard Generation Plant during most outages.

In addition, a much anticipated project was completed in the Eagle Run area last June. Cooperative crews relocated the wire that serves the neighborhood, a realignment that will be served more efficiently by the Gerry Willard Generation Plant.

COMMITMENT TO CONSERVATION & RENEWABLES

NET METERING

Homer Electric Association was the first utility in the state to adopt net metering standards designed to encourage the development of member-owned renewable energy systems. Our net metering program allows a member to reduce the amount of electricity purchased by interconnecting on-site member-owned or leased generation facilities. Under the new regulations, the amount of member-generated power offsets their electric consumption. The member is then billed for net electric consumption or credited for generating more electricity than was used.

Currently, HEA has a total of 38 member-owned interconnections that have a capacity of producing 107 kW of renewable power; 28 are wind generators and are 10 solar panels.

HEA ENERGY & CONSERVATION FAIR

In November 2010, HEA played host to the second annual Energy and Conservation Fairs that were held in Kenai and in Homer. The events focused on sensible energy solutions and featured local businesses and/or organizations that disseminated information on the latest technologies, programs, and products to help members learn more about energy consumption options. The fairs included more than 30 vendors with expertise in the areas of energy-saving devices and techniques; all housed in one location. With more than 800 people attending both events, the Energy & Conservation Fairs were deemed a huge success.



ENERGY EFFICIENCY & CONSERVATION STUDENT CONTEST

In conjunction with the Energy & Conservation Fairs, Homer Electric introduced its first annual Energy Efficiency & Conservation contest for students in grades three through eight. Area students were given the opportunity to enhance their skills in science, writing, and technology and winners received various awards and prizes that were presented during the event.



COMMITMENT TO SAFETY

SAFETY ACCREDITATION PROGRAM

Homer Electric has received Safety Accreditation in 2010 through the Rural Electric Safety Accreditation Program (RESAP) which is administered by the National Rural Electric Cooperative Association (NRECA). The program is a peer-review safety and loss control evaluation of electric utilities that consists of an organized analysis of a system's safety and loss control program that measures overall effectiveness. While the safety accreditation program looks at many areas of a system's operations, foremost is management's role and commitment to achieve and maintain high safety standards for the protection of its employees and the community it serves.

This was the 10th consecutive three-year period in which Homer Electric has participated in the program and successfully met the necessary requirements to join the ranks of accredited utilities across the United States. The accreditation is valid for three years.

EMPLOYEE RETIREMENTS

Homer Electric Association employs an exceptional pool of employees with strong work ethics who are dedicated to their family and community. Join us in congratulating the recent retirees for their many years of dedicated service, commitment, and professionalism:

SYLVIA DALE

Engineering Tech II in Kenai – Retired after 26 years.

KAREN FANN

Projects Administrator in Homer – Retired after 21 years.

BARNEY JIMENEZ

Engineering Tech Foreman in Homer – Retired after 9 years.

IN LOVING MEMORY

The following are special members of the Homer Electric family who will always be remembered and forever in our hearts.

JIM COOPER

Fondly known as Safety Coop, Jim was hired in 2001 and held the position of Safety Coordinator until he retired in 2007.

DEANNA DUCK

Deanna was hired in 2006 as a Member Service Representative in Kenai and left Homer Electric in 2009.

CAROL HUMBYRD

Carol was hired in 1976 as the Engineering & Operations Secretary and held several different positions until her retirement as the Administrative & Rates Analyst in 1992.

2010 TREASURER'S ANNUAL REPORT

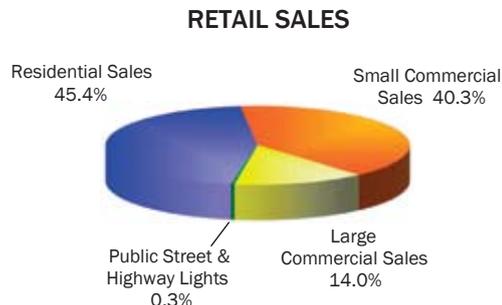
Homer Electric Association, Inc. (HEA) is committed to establishing rates that allow us to provide reliable electric service at fair and reasonable prices for our members. One element to meeting that commitment, and a key component of sound financial management, is by developing strong financial objectives and working within the confines of those parameters.

HEA met all of its financial goals in 2010 and concluded the year with consolidated revenues and non-operating income that totaled \$74.8 million; resulting in a positive margin of \$3.8 million.

Other 2010 financial highlights include the following:

RETAIL SALES:

In total, 470 million kilowatt hours (kWh) of electricity were sold in 2010, a decrease of 2.7 percent from the previous year. The reduction in sales was primarily due to a 9% drop from the large commercial sales class.



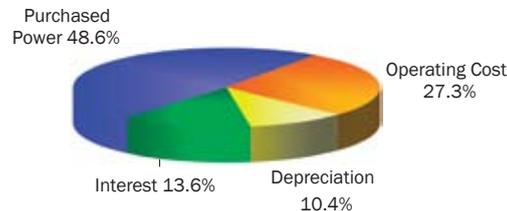
REVENUES:

Revenue generated from energy sales totaled \$64.9 million. This was a decrease of 18 percent as compared to 2009 and largely due to a combination of lower than anticipated wholesale power costs and a reduction in energy sales.

WHOLESALE POWER COST RATE ADJUSTMENT (WPCRA):

The WPCRA is a cost component within the energy rate structure that reflects changes in the cost of purchased power due primarily by the fluctuating cost of fuel used to generate electricity. The WPCRA increased from .181 cents per kWh on January 1, 2010, to 0.715 cents per kWh on December 31, 2010. The upward trend continued into 2011 when the WPCRA increased sharply to 4.171 cents per kWh on April 1, 2011. The rise in wholesale power cost is expected to continue, though not as sharply, throughout 2011 due to rising fuel costs.

EXPENSES



EXPENSES:

Cooperative expenses for 2010 totaled \$71.0 million, which is down \$15.7 million (18 percent) from 2009. Purchased power costs decreased by \$15.2 million and comprised 48.6 percent of the total, down 8.8 percent from the previous year. Operating costs, depreciation expense and interest expense remained about the same.

CAPITAL CREDITS:

In 2010, the HEA Board of Directors approved the retirement of Capital Credits Payment to Estates in the amount of \$135,578.

NEW SERVICES (METERS):

At the end of 2010, HEA calculated a total of 31,829 active meters, an increase of 1.2 percent from 2009. In all, there were 552 new electric services added to our system in 2010 as compared to 477 in 2009.



Alan Bute, Treasurer

Homer Electric Association, Inc. and Subsidiary Consolidated Balance Sheets

December 31, 2010 and 2009

| <u>ASSETS</u> | <u>2010</u> | <u>2009</u> | <u>EQUITIES & LIABILITIES</u> | <u>2010</u> | <u>2009</u> |
|---|----------------------|----------------------|--|----------------------|----------------------|
| Utility plant, at cost: | | | Equities and margins: | | |
| Electric plant in service | \$293,314,793 | \$275,866,788 | Memberships | \$67,060 | \$70,000 |
| Electric plant held for future use | 21,671,980 | 21,700,695 | Patronage capital | 63,404,829 | 59,776,812 |
| Construction work in progress | <u>28,875,157</u> | <u>15,290,488</u> | Other equities - donated capital | <u>2,340,183</u> | <u>2,344,228</u> |
| Total utility plant, at cost | 343,861,930 | 312,857,971 | Total equities and margins | <u>65,812,072</u> | <u>62,191,040</u> |
| Less accumulated depreciation & amort.... | <u>(121,277,120)</u> | <u>(118,024,954)</u> | | | |
| Net utility plant | <u>222,584,810</u> | <u>194,833,017</u> | | | |
| Other assets and investments: | | | Long-term debt-mortgage notes payable... | <u>174,054,140</u> | <u>152,774,977</u> |
| Investments in assoc. organizations..... | 18,152,618 | 16,820,587 | | | |
| Other investments | 207,309 | 215,437 | Current liabilities: | | |
| Notes receivable, net of current portion.... | 823,843 | 996,290 | Current portion of long-term debt | 6,951,509 | 6,281,531 |
| Non-utility property, net of accum. depreciation of \$299,459 (\$263,763 in 2009) | <u>527,309</u> | <u>503,501</u> | Accounts payable | 5,426,205 | 5,920,320 |
| Total other assets and investments | <u>19,711,079</u> | <u>18,535,815</u> | Consumer deposits | 1,017,145 | 1,020,630 |
| Current assets: | | | Accrued payroll and benefits | 1,890,301 | 1,797,724 |
| Cash and cash equivalents..... | 6,807,597 | 9,821,389 | Accrued taxes and other current liabilities | <u>934,655</u> | <u>739,721</u> |
| Accounts receivable, less provision for doubtful accounts of \$109,073 (\$91,466 in 2009) | 5,899,072 | 5,850,532 | Total current liabilities | <u>16,219,815</u> | <u>15,759,926</u> |
| Unbilled revenue | 3,506,116 | 3,532,292 | | | |
| Materials, fuel and supplies inventory | 4,032,850 | 3,892,064 | Deferred credits | <u>17,169,874</u> | <u>22,838,032</u> |
| Notes receivable, current portion | 506,784 | 360,000 | | | |
| Other current and accrued assets | <u>452,871</u> | <u>413,029</u> | Total equities and liabilities | <u>\$273,255,901</u> | <u>\$253,563,975</u> |
| Total current assets | <u>21,205,290</u> | <u>23,869,306</u> | | | |
| Deferred charges | <u>9,754,722</u> | <u>16,325,837</u> | | | |
| Total assets | <u>\$273,255,901</u> | <u>\$253,563,975</u> | | | |

Consolidated Statements of Operations & Patronage Capital

Years Ended December 31, 2010 and 2009

| | <u>2010</u> | <u>2009</u> |
|--|---------------------|---------------------|
| Operating revenues | \$72,624,826 | \$87,283,352 |
| Operating expenses: | | |
| Purchased power costs | 34,539,149 | 49,762,798 |
| Transmission expense | 1,367,012 | 1,104,527 |
| Distribution - operations | 1,631,803 | 1,395,001 |
| Distribution - maintenance | 4,545,890 | 4,456,800 |
| Production - maintenance | 1,046,191 | 653,097 |
| Consumer accounts | 2,796,486 | 3,008,364 |
| Customer service and information | 614,039 | 383,227 |
| Sales expense | 101,000 | 142,931 |
| Administrative and general | 7,095,075 | 7,440,164 |
| Depreciation and amortization | 7,396,480 | 8,389,082 |
| Taxes | 232,398 | 239,522 |
| Miscellaneous | 211,507 | 463,395 |
| Total operating expenses | <u>61,577,030</u> | <u>77,438,908</u> |
| Operating margins before fixed charges | 11,047,796 | 9,844,444 |
| Fixed charges: | | |
| Interest on debt | 9,435,998 | 9,292,260 |
| Allowance for funds used during construction | <u>(417,561)</u> | <u>(541,968)</u> |
| Net fixed charges | <u>9,018,437</u> | <u>8,750,292</u> |
| Operating margins after fixed charges | 2,029,359 | 1,094,152 |
| Patronage capital allocation | <u>1,449,151</u> | <u>534,967</u> |
| Net operating margins | 3,478,510 | 1,629,119 |
| Nonoperating margins: | | |
| Interest income | 242,828 | 688,483 |
| Other income | <u>42,257</u> | <u>31,534</u> |
| Total nonoperating margins | <u>285,085</u> | <u>720,017</u> |
| Net margins | 3,763,595 | 2,349,136 |
| Patronage capital at beginning of year | 59,776,812 | 59,676,651 |
| Less retirement of patronage capital credits | <u>(135,578)</u> | <u>(2,248,975)</u> |
| Patronage capital at end of year | <u>\$63,404,829</u> | <u>\$59,776,812</u> |



BOARD OF DIRECTORS

Debbie Debnam, President

Bill Fry, Director

Tim Evans, Vice President

Ed Oberts, Director

Alan Bute, Secretary/Treasurer

David B. Thomas, Director

Jim Levine, Deputy Secretary

Bill Warren, Director

Mike Wiley, Director

MISSION STATEMENT

To provide reliable electricity to our members and our community through superior customer service & innovative energy solutions at fair & reasonable prices.



**Homer Electric
Association, Inc.**

A Touchstone Energy® Cooperative 