



Bradley Lake Hydroelectric Project



**Homer Electric
Association, Inc.**

A Touchstone Energy® Cooperative



2007 ANNUAL REPORT

Renewable Resources – Innovation & Improvement

Message from the President and General Manager

As we celebrate the 50th Anniversary of Alaska's statehood this year, it seems proper to remember that Homer Electric Association (HEA) has been providing service to the residents of the western Kenai Peninsula since 1945, over a decade before statehood. HEA has been blessed with hundreds of well-trained and dedicated employees who have served many tens of thousands of residents.

On behalf of the board of directors of HEA, we would like to say "Thank You" to the members of our cooperative. The success of HEA is a reflection of the values and characteristics of its membership. The membership, through its elected board of directors, has been charting the cooperative's course of action for more than a half a century. Today, thanks to the foresight of our membership, HEA is one of the state's leading electric cooperatives and has a bright future ahead.

POWER SUPPLY PLANNING

This past year has been an exciting one for HEA. The cooperative is busy making plans for December 31, 2013, when our wholesale power contract with Chugach Electric Association expires. The possibility of owning our own generation and transmission facilities, along with establishing partnerships with other Railbelt utilities, is being carefully considered. These discussions are taking place in earnest due to the fact the planning and construction of a new power generation plant takes several years to complete.

As part of that effort, HEA recently signed two Memorandums of Understanding. The first one, signed by HEA, Chugach Electric, and Golden Valley Electric, sets the stage for the development of a Unified Power Provider (UPP). The entity would oversee the power generation and transmission needs for the Railbelt area,

from Fairbanks to Homer. As envisioned by the three cooperatives, the UPP would be governed by representatives from each of the Railbelt utilities along with the State of Alaska. The creation of a UPP was one of the recommendations of the 2004 Alaska Energy Policy Task Force and HEA is committed to exploring the idea.

In addition, HEA, Chugach Electric, and Municipal Light and Power (Anchorage) have signed a Memorandum of Understanding to jointly pursue the development of a gas-fired generation plant in south Anchorage. Under the terms of the MOU, the utilities would work together on the planning and construction of the plant and associated transmission facilities. While many details still need to be worked out, the plant could be on line by 2012. The HEA Board continues to examine what is best for our members, with the option of owning our own generation facilities still on the table.

As we prepare for 2014, HEA is also exploring the potential for integrating renewable energy sources into its power generation portfolio. The results of a survey done in the spring of 2007 indicated a majority of our members support using renewable sources such as wind, solar, and hydro to generate electricity. Toward that end, HEA is partnering with a private company, Wind Energy Alaska, to evaluate several potential wind and hydro sites on the Kenai Peninsula. We are hopeful the studies will lead to the installation of renewable energy projects that will benefit the members of HEA.

MEMBER SERVICE IMPROVEMENTS

We are also excited about progressive changes taking place at HEA that will result in better service to our members. The Automated Meter Reading project is in full swing and as of this spring nearly 17,000

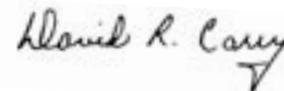
meters have been changed out. The new meters provide instantaneous readings of energy use and greatly reduce the number of estimated billings.

HEA members have also seen the benefits of an aggressive right-of-way clearing effort. This on-going project has resulted in a substantial reduction in the number of outages caused by trees coming into contact with power lines. The clearing work has also reduced the potential fire hazard posed by trees being in close proximity to energized lines.

In partnership with our national association, Touchstone Energy, HEA recently added an energy efficiency site on our web page. The site offers a variety of services including an on-line energy audit tool.

These are just a few examples of the innovative and proactive steps being taken at HEA to better serve our members. In closing, we would like to acknowledge the hard work and dedication of HEA employees. This dedicated staff continues to provide outstanding service to the membership. Whether it's assisting a member with a billing question or braving sub-zero weather conditions to repair a downed power line, HEA employees are working throughout the year to provide the best service possible.

HEA is proud to be part of the Kenai Peninsula community and we look forward to an exciting and prosperous future.



David Carey, Board President



Brad Janorschke, General Manager

2007 Year in Review

Homer Electric Association had many accomplishments in 2007 including the completion of a member survey relating to future power sources, the continued discussions with Wind Energy Alaska, the resolution of the Chugach wholesale rate case, the successful continuation of HEA's automated meter reading project, the aggressive tree clearing program, the introduction of a new technology to extend underground cable life, the completion of civil work required for the Diamond Ridge Substation, and significant success on several Bradley Lake Hydroelectric plant projects.

MEMBER SURVEY

In the spring of 2007, Homer Electric surveyed 300 residential members to gather some information about preferences for various sources of power generation. The telephone survey was conducted by a private company who specialized in utility-oriented surveys. The members surveyed were equally distributed among the three HEA districts and asked four questions related to energy generation and several other questions to gather demographic information such as age, gender, length of residency, etc. The results of the survey indicated members are interested in the cooperative pursuing renewable energy projects. A majority of the members (75%) also indicated they would be willing to pay more for renewable energy on their monthly bill. Based on that feedback, Homer Electric hosted two renewable energy community forums and has posted an online poll to measure the membership's interest in voluntarily financially supporting a renewable energy program. The survey results indicate a clear preference for renewables, but also reflect a concern about increasing rates. This is the balance Homer Electric will seek to achieve as it pursues options for future power generation.

CHUGACH RATE CASE

A significant highlight of 2007 was the negotiated settlement of the rate case with Chugach Electric. The Regulatory Commission of Alaska approved the settlement, which saved hundreds

of thousands of dollars in legal fees, and was a win-win for each cooperative. The settlement provides Chugach Electric with approximately one half the \$2.8 million increase they were requesting.

DIAMOND RIDGE SUBSTATION

To provide greater reliability and to accommodate the growth in Homer, a new substation is being constructed in the Diamond Ridge area. The current Diamond Ridge Substation

is a transmission station, providing 69 kilovolts of power to the Hatfield Substation in Homer. The new Diamond Ridge Substation will serve as both a transmission and distribution substation that will improve HEA's ability to serve the growing demand for energy in the Homer area. Construction is expected to begin mid-summer of 2008 and will take approximately a year for completion.

WIND ENERGY ALASKA

During 2007, Homer Electric continued to explore various options for producing renewable energy on the Kenai Peninsula. The most exciting development was an agreement between Homer Electric and Wind Energy Alaska to share resources regarding potential wind and small hydro facilities on the Kenai Peninsula. Wind Energy Alaska is a subsidiary of a renewable energy company, EnXco, and Cook Inlet Region, Inc. (CIRI).

Currently, Homer Electric has three meteorological towers on the Kenai Peninsula that are gathering wind information. Generally, two years worth of data is desired in order to determine the economic feasibility of a site. Homer Electric is hopeful that the sites under review will meet the required standards and wind generation can become a reality by 2010.

In addition to evaluating wind sites, Homer Electric and Wind Energy Alaska have also been exploring the potential of small hydro projects on the Kenai Peninsula. The four sites under consideration have the potential to each produce between 5 and 10 megawatts of power. During 2008, Homer Electric will continue to work at obtaining necessary

permits for the projects and determine the feasibility of each of the sites.

On a regional wide level, the Fire Island wind project near Anchorage continues to be a potential source of renewable energy. Recently, issues with the Federal Aviation Administration were resolved and the federal agency is satisfied that the project will not interfere with operations at the Ted Stevens International Airport. Homer Electric, along with several other electric utilities, has expressed interest in seeing Fire Island developed.

Kenai Peninsula Meteorological Tower



HAZARD TREE REMOVAL PROJECT

Homer Electric has mounted an aggressive tree clearing program, using a combination of grants and cooperative funds. The cooperative plans to continue this effort over the next several years to protect facilities and lessen the chance of wildfires.

Thanks to the efforts of the Kenai Peninsula legislative delegation, and in particular Representative Mike Chenault, HEA received a \$250,000 Designated Legislative Grant to remove hazard trees. The state appropriation was used to protect a power line that is vitally important to residents of Halibut Cove, Seldovia, Port Graham, and Nanwalek. The beetle-killed trees, many located outside the right-of-way, come into contact with power lines on a regular basis, causing damage to electric facilities and creating costly power outages for our members. The situation is also creating a serious fire hazard.

In the summer of 2007, tree clearing crews worked in the Neptune Bay area and removed over 4,000 beetle-killed spruce trees outside of the right-of-way. This work, in conjunction with prior clearing efforts, has resulted in a significant improvement to the electric service provided to HEA members living on the south side of Kachemak Bay.



Bradley Lake HYDROELECTRIC PLANT

Bradley Lake Hydroelectric Plant is the largest of seven hydroelectric facilities in the state, with a capacity of 120 megawatts. The Bradley Lake facility has been serving the Railbelt customers for 16 years and is a state-owned facility that is operated and maintained by Homer Electric.

Several significant maintenance projects were completed at the Bradley Lake Hydroelectric Plant in 2007. The completion of the governor replacement job provided for the replacement of the control system that operates the machines on a day-to-day basis and makes the units more responsive during system disturbances. This has been an ongoing project to correct some issues with the governors since their original installation at Bradley Lake. The final tuning was completed in the spring of 2007. In addition to the replacement of the governors, two main turbine wheels at Bradley Lake were replaced.

HEA also improved the communications system at Bradley Lake by replacing the

original communications circuit (fiber optic cable laid cross country through the woods) that supplied power and control to the dam with new underground communications and power cables that run parallel to the road. This enabled the installation of a microwave communication facility along the

Bradley Lake road and is now accessible by vehicle during most of the year. The old microwave communications were only accessible by helicopter. The benefits of this installation are additional control features and increased bandwidth to and from the Bradley Lake facility.



Fishwater release valves



CABLE INJECTION PROJECT

Homer Electric was introduced to a technology that extends the life of underground power cables. HEA's system includes over 100 miles of underground conductor that may be eligible for this new cable injection process. The solution that is injected into the cable can extend the life of

the cable for 40 years or more. A pilot project was conducted in some Kenai and Anchor Point neighborhoods last year in which 41% of the underground cable was injected. Using this technology can greatly reduce the cost of rebuilding the aging underground system.

AUTOMATED METER READING (AMR)

Homer Electric completed the third year of a five-year program to install automated meters (AMR) in our service territory. The AMR meters, which are digital meters that send a signal back to HEA through the power lines, are replacing the old mechanical meters. The AMR system provides Homer Electric and its members with numerous customer service and cost saving benefits including reducing the number of estimated meter readings for billing purposes.



By the spring of 2008, AMR meters will have been installed in North Kenai, Kenai, Soldotna, and Kasilof areas with well over a 90% success rate. AMR meters will be installed in Sterling, Ninilchik, Anchor Point and areas of Homer during the remainder of 2008.



IN REMEMBRANCE

Billy Thompson

April 27, 1946 – January 13, 2008

Homer Electric remembers Billy Thompson, a special member of the HEA family, who will be greatly missed. Billy worked at HEA for 26 years and was the Superintendent in Kenai. He retired in 2004.

Employee

LONGEVITY AWARDS & RETIREMENTS

Homer Electric takes pride in who we are as a cooperative. Your local electric cooperative is made up of a team of familiar faces in the community who work to ensure you have safe, reliable electric service on a daily basis. Join us in congratulating the following employees for their many years of commitment, hard work and professionalism:

DALE OVERTURFF

Foreman in Kenai, retired after 30 years working at Homer Electric.

DENNIS BARNARD

Lead Warehouseman, retired after 30 years at Homer Electric.

GERRY WINKLER

Foreman at Nikiski Cogeneration Plant, retired after 20 years at Homer Electric.

MARY STENGA

Member Service Representative in Kenai, retired after 20 years at Homer Electric.

JIM COOPER

Safety Coordinator, retired after 15 years total at Homer Electric.

DARLENE JONAS

I/S Coordinator/Analyst, celebrated her 30-year employment anniversary at Homer Electric.

CINDY FRAZIER

Engineering Services Specialist, celebrated 10 years with at Homer Electric.

Treasurer's 2007 Annual Report

Homer Electric Association is committed to establishing electric rates that allow us to provide reliable, competitive utility services to our consumer-owners.

Homer Electric concluded the year 2007 with total consolidated revenues and non-operating income of \$73.6 million. That, combined with total consolidated costs of electric service of \$70.9 million resulted in a positive margin of \$2.7 million. The following is a financial summary for the year.

RETAIL SALES:

Homer Electric sold 529.6 million kilowatt-hours of electricity in 2007, an increase of 7 percent from 2006. Large commercial sales accounted for most of the increased kWh sales.

REVENUES:

Revenue from energy sales was \$61.6 million, up from 2006. Primarily the increase in revenue was attributed to increased kilowatt hour sales in the large commercial class. This increase was somewhat offset by decreased kWh sales and revenue in the residential and small commercial classes.

KEY RATIO:

HEA's equity-to-total assets ratio (the accumulated ownership of the members in the assets of the utility) was 32.6 percent at year end, down .9 percent from 2006. The equity-to-total assets ratio of Alaska Electric & Energy Cooperative (AEEC), a single member cooperative which owns Homer Electric's generation and transmission assets, was 20%. Both Key Ratios are in compliance with our debt covenant requirements.

WHOLESALE POWER COST ADJUSTMENT:

This is the rate that reflects changes in the cost of purchased power. The wholesale power cost rate decreased from \$.02402 per kWh on January 1, 2007 to \$.00793 on December 31, 2007. Throughout the year the rate varied greatly resulting in an average WPCRA of \$.008945 per kWh.

CAPITAL CREDITS:

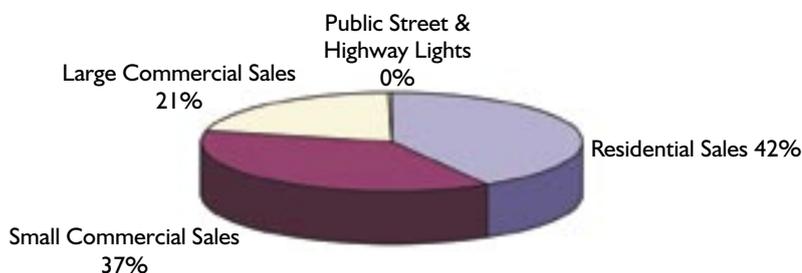
In 2007 the Board of Directors approved General Capital Credit retirements of \$600,000.

SYSTEM:

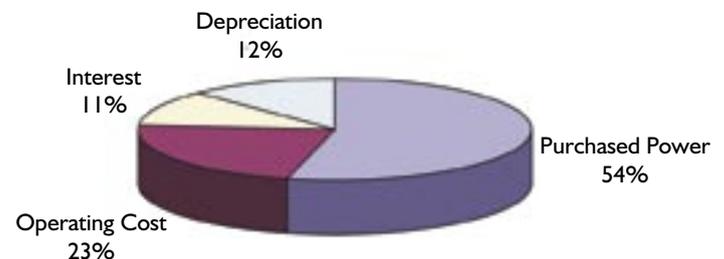
Services in place at year end totaled 30,255, a 1.6 percent increase from 2006. There were 605 new services connected and 113 services retired, resulting in 492 additional services for the year.

In conclusion, Homer Electric had a financially productive year while keeping costs and rates down, providing greater value to its members.

RETAIL SALES



EXPENSES



Financial Statements

Homer Electric Association, Inc. Consolidated Balance Sheets December 31, 2007 and 2006

ASSETS	2007	2006	EQUITIES & LIABILITIES	2007	2006
UTILITY PLANT (at cost) :			EQUITIES AND MARGINS:		
Electric plant	\$261,074,606	\$251,670,951	Memberships	\$77,625	\$82,915
Electric plant held for future use	3,794,790	3,732,894	Patronage capital	53,195,628	51,183,575
Construction work in progress	13,789,561	5,980,453	Other equities - donated capital	2,098,177	2,007,073
Total Utility Plant	278,658,957	261,384,298	Total equities and margins	55,371,430	53,273,563
Less accumulated depreciation & amort....	(104,399,494)	(97,138,490)			
Net utility plant	174,259,463	164,245,808			
OTHER ASSETS AND INVESTMENTS:					
Investment in assoc. organizations.....	17,053,514	16,836,803			
Other investment	241,350	257,607	LONG-TERM DEBT:		
Notes receivable	1,184,982	1,753,635	NRUCFC mortgage notes	143,156,538	135,634,555
Non-utility property, net of accum. depreciation of \$192,505 in 2007 and \$156,809 in 2006.....	573,503	609,199			
Total other assets and investments.....	19,053,349	19,457,244			
CURRENT ASSETS:					
Cash & cash equivalents	30,507,948	35,510,733	CURRENT LIABILITIES:		
Accounts receivable, less allowance for doubtful accounts of \$67,416 in 2007 and \$111,102 in 2006.....	4,798,395	6,828,267	Current portion of long-term debt	5,365,390	4,929,124
Unbilled revenue	2,412,304	3,400,000	Accounts payable	4,890,837	5,362,850
Materials, fuel and supplies	3,883,939	3,067,278	Consumer deposits.....	977,090	904,730
Notes receivable, current portion	465,000	375,000	Accrued payroll and benefits	1,451,689	1,230,964
Other current and accrued assets	460,169	412,463	Accrued taxes and other current liabilities	649,108	784,337
Total current assets	42,527,755	49,593,741	Total current liabilities.....	13,334,114	13,212,005
DEFERRED CHARGES	10,812,914	11,344,328	DEFERRED CREDITS.....	34,791,399	42,520,998
	<u>\$246,653,481</u>	<u>\$244,641,121</u>		<u>\$246,653,481</u>	<u>\$244,641,121</u>

Consolidated Statements of Operations & Patronage Capital Years Ended 2007 and 2006

	2007	2006
Operating Revenues	\$69,912,396	\$67,651,388
Operating Expenses:		
Cost of power	38,303,434	37,332,222
Transmission expense	619,007	541,025
Distribution - operations	1,444,878	1,240,654
Distribution - maintenance	4,154,796	3,988,415
Production - maintenance	499,487	329,805
Consumer accounts	2,784,369	2,715,373
Customer service & information.....	266,500	303,287
Sales expense	114,759	150,309
Administrative and general	5,866,348	5,397,172
Depreciation and amortization.....	8,021,663	7,682,682
Taxes	267,540	245,902
Miscellaneous	195,205	194,660
Total operating expenses	62,537,986	60,121,506
Operating margins before fixed charges	7,374,410	7,529,882
Fixed charges:		
Interest on debt	8,444,003	7,322,225
Allowance for borrowed funds used during construction....	(276,918)	(340,889)
Total fixed charges	8,167,085	6,981,336
Operating margins (loss) after fixed charges	(792,675)	548,546
Patronage capital allocation	1,217,113	1,221,571
Net operating margins	424,438	1,770,117
Non-operating margins:		
Interest income	2,190,033	1,336,525
Other income (expense)	119,657	(15,413)
Total non-operating margins	2,309,690	1,321,112
Net margins	2,734,128	3,091,229
Patronage capital - beginning of year.....	51,183,575	48,201,035
Less retirement of patronage capital credits	(722,075)	(108,689)
Patronage capital - end of year	\$53,195,628	\$51,183,575

MISSION STATEMENT

To provide reliable, competitive utility services to our consumer-owners.

POWER

Nikiski Cogeneration Project 39.0 MW
Seldovia Power Plant 2.5 MW
Bradley Lake Hydroelectric Plant 14.0 MW*
*Homer Electric's share of Bradley Lake's 120 megawatt capacity is 14 MW. The remainder of power needed is purchased through contract or on the economy energy market.

YOUR COOPERATIVE AT A GLANCE

- 20,737 member-owners
- 30,279 meter locations
- 2,287 total miles of energized line
- 9 members per mile of line
- 13 meters per mile of line
- 3,166 square-mile service area



BOARD OF DIRECTORS

Seated L to R:

Ruth Fitzpatrick, Director
Mike Nugent, Secretary/Treasurer
David Carey, President
Hugh Chumley, Vice President
Debbie Debnam, Deputy Secretary

Standing L to R:

J. Michael Pate, Director
Brian Hirsch, Director
Bruce Passe, Director
Donald Seelinger, Director