Homer Electric Association, Inc.

2008 ANNUAL REPORT

Renewable Resources Innovation & Improvement

Homer Electric Association, Inc.
A Touchstone Energy® Cooperative
Message from the President & General Manager

It has been our honor and privilege to serve Homer Electric. The challenges that the Board and management have dealt with during 2008 have strengthened our belief that Homer Electric is the best cooperative in the state. Our members continue to stay informed about utility issues and their active participation in the cooperative is very much appreciated.

As we continue to celebrate the 50th anniversary of Statehood, it is important to recognize that Homer Electric Association is observing its 64th year of service to residents of the western Kenai Peninsula. In 1945, a small group of pioneers gathered around a table in Homer to devise a plan to bring electricity to the area. Ralph de Rose, Walter Christensen, Carl Sholin, Virgo Anderson, Ray Lentz, Hugh Watson, Robert Kranich, and James Faulk had a vision and were determined to turn that vision into reality.

How exciting it must have been when, five years later, the first line was energized and electricity was available to the original 56 members of Homer Electric Association. The event created a groundswell of pride and enthusiasm as electricity was brought into homes and businesses in the area. Within a few years, Homer Electric Association expanded, bringing electricity up the road towards Ninilchik and on into Soldotna and Kenai. The “energy” that created that expansion is something that has always been a part of Homer Electric Association.

Obviously, much has changed since 1945, but while there have been huge advances made in the technological end of the business, the basic founding principles of the cooperative have not changed.

Our goal today, just as it was back in 1945, is to provide reliable, affordable electric service to our members. While we face challenges, the same “can-do” attitude that characterized our founding members continues to exist today at Homer Electric Association.

2008 was a year which Homer Electric Association dealt with unprecedented increases in the cost of fuel used to generate electricity. The increases, which are passed on to Homer Electric, translated into fuel cost adjustments that raised electric rates significantly. This created a considerable economic hardship on our members. The Board of Directors is extremely concerned about the situation and is taking steps to address the issue.

Our goal is to remove Homer Electric from its nearly complete dependence on natural gas for power generation. This over-dependence on natural gas is what created our rate crisis in 2008. By seeking out additional sources of power, it is our hope we can have a diversified pool of energy sources to choose from, thus avoiding large swings in fuel costs.

Between now and 2014, when our power supply contract with Chugach Electric expires, we will be investigating all types of potential energy sources to determine which mix will provide Homer Electric members with the most reliable, affordable, and environmentally responsible energy possible.

We are very much aware of how important it is for our members to have affordable electric rates and we promise you that the Board will do everything it can to reach that goal.

We believe that if we approach the coming years with the same attitude our founding members had, we will develop a plan that will insure a prosperous future for Homer Electric Association.

In closing, we would like to extend a heartfelt thank you to three of our former Board members who recently resigned from the Homer Electric Board of Directors. Dave Carey left the Board after being elected Kenai Peninsula Borough Mayor in October and Board member Hugh Chumley resigned as well to become Mayor Carey’s Chief of Staff. The knowledge and expertise that both Mayor Carey and Mr. Chumley brought to the Board of Directors over the many years they served cannot be overstated. We wish them both the best in their new positions with the Borough.

Also, we say goodbye and good luck to Board member Bruce Passe of Kenai. Bruce served on the Board for six years and his valuable contributions will be missed. We send along our best wishes to Bruce and his family as they embark on a new adventure outside of Alaska.

Finally, we’d like to applaud the efforts of Homer Electric employees. It has been a pleasure to work with all of them and we appreciate their efforts and dedication.
This year is a milestone for Alaskans as we celebrate Alaska’s 50th anniversary as a state. Alaska has come a long way since President Dwight D. Eisenhower signed the Alaska Statehood Act into United States law on July 7, 1958, which paved the way for Alaska becoming the 49th state on January 3, 1959. Your electric cooperative has also come a long way since its incorporation 64 years ago.

In 1945, while Alaska was still recognized as the Territory of Alaska, Homer streets were dark except for the flicker of candles and lanterns from the windows of homes. In those days, only the “city folks” had electricity. A few homesteaders constructed their own electrical systems. Sam Pratt had a pelton wheel that was turned by water from a dammed-up creek. It produced just enough electricity to run the lights in his home, a refrigerator, and a washing machine.

Even with these “modern” conveniences, Sam had bigger ambitions. He and a group of forward-thinking citizens in the Homer area met in his home and began working together to form an electric cooperative. Robert Kranich was the first to suggest contacting the Rural Electrification Administration (REA) about getting a loan. REA required nine incorporators; they were Ralph M. de Rose, Walter Christensen, Carl A. Sholin, Virgo W. Anderson, Ray V. Lentz, Hugh S. Watson, Robert W. Kranich, Samuel L. Pratt, and James N. Faulk, Sr. These pioneers made up Homer Electric Association’s first Board of Directors. Their first official meeting was December 17, 1945. Homer Electric purchased a government surplus 75 KW Caterpillar generator in 1946. At that time, locals couldn’t imagine how they could use all that power.

Getting to the point of energization was a five-year process of hard work. Line construction began at Fritz Creek on May 15, 1949, terminating in Homer. HEA’s line crew (a total of three linemen) had to dig the pole holes by hand at a top speed of about six holes per man per day.

Lineman Karl Baier had the honor of turning on the power at 7:07 p.m. on March 13, 1950, for 56 members of the cooperative. Over the years, several more generators were added to keep up with the demand. In 1954, lines were built north to Clam Gulch and, in 1957, through Soldotna toward Kenai. By 1960, HEA lines were serving homesteads at Nikiski Beach.

More generation was needed, so Homer Electric began negotiating with Chugach Electric Association in Anchorage to purchase 3,750 KW from the Cooper Lake Hydroelectric Plant. By 1963, HEA had constructed the Kasilof Substation in order to distribute that additional power, and the Chugach contract was amended to add 5,000 KW from the Bernice Lake gas turbine plant. HEA also expanded its service area by purchasing the Seldovia electrical system in 1964 and Kenai City Light System in 1971. Halibut Cove, Sadie Cove, Tutka Bay, and China Poot Bay received power lines in 1969 and were served from the Seldovia Power Plant.

We’ve come a long way since Homer Electric’s incorporation 64 years ago with a starting membership of 56 members. Today Homer Electric serves more than 20,200 members over a 3,166 square-mile service area and employs 125 full-time employees. As the electric needs of the lower Kenai Peninsula grow, Homer Electric strives to meet those needs through innovative energy solutions at reasonable prices. The following projects are some of the highlights from 2008.
Homer Electric’s Sustainable Natural Alternative Power (SNAP) program makes small-scale solar, wind, geothermal or biomass power more cost-effective for customers. The program simply connects customers who want to produce alternative power with other local members who want to support the development of new, renewable energy.

In 2007, a Homer Electric member survey revealed that members would be willing to pay a little extra each month to support renewable energy. The SNAP program offers that opportunity to support the generation of alternative energy by local members!

Under the SNAP program, Homer Electric members can voluntarily contribute money to a fund that will be distributed back to renewable energy producers on an annual basis. When you contribute to SNAP, you become an important part of developing local, eco-friendly, renewable power. The money that supporters contribute is divided among the SNAP power producers, with payments based on how much money is contributed to the fund and how much renewable power each producer has generated.

The cooperative does not keep any of the funds designated by members of SNAP. Your contribution is distributed annually to the producers and supports your neighbors in developing alternative energy resources on the Kenai Peninsula.

The program is proving popular with producers, with two solar projects and three wind projects already on line. Several more members have contacted Homer Electric for information on how to install a system and participate in the program. The success of the SNAP program will depend on voluntary monetary contributions from Homer Electric members.

**Small Hydro Projects**

Over 90 percent of the electricity purchased by Homer Electric is generated using natural gas and when natural gas prices increase, the impact is seen down the line by HEA rate payers.

This over dependence on natural gas is something HEA is trying to reduce. At the end of 2013, HEA’s power purchase contract with Chugach Electric will expire. After that HEA will generate its own electricity using a mix of fuel sources.

One of the more promising renewable sources being considered are small hydro projects. The Federal Energy Regulatory Commission (FERC) has approved four preliminary permits that will allow Homer Electric Association, in partnership with Wind Energy Alaska, to study potential small hydro sites on the Kenai Peninsula. The permits cover four sites located in the Moose Pass – Seward area: Ptarmigan Creek/Lake, Falls Creek, Crescent Lake, and Grant Lake.

Under the permits, Homer Electric has a three year window to investigate the sites and move ahead with engineering, economic, and environmental evaluations. This work is required before an application for a project license can be made. Each of the sites has the potential to produce approximately two to five megawatts of power.

**Wind Energy Projects**

Homer Electric and Wind Energy Alaska are also investigating wind power generation on the Peninsula.

In October 2008, a $4M application was made to the Alaska Energy Authority (AEA) for a wind project on the south end of the Peninsula. In addition, HEA has been contacted by other “interested parties” who are pursuing commercial scale wind projects on the peninsula.

Wind Energy Alaska installed two meteorological towers on the southern area of the peninsula and one tower in the Caribou Hills area to collect wind data. Normally, about two years worth of wind data is required to evaluate the potential of a wind generation site. The first two towers were raised in 2007 and a third tower was installed in March 2008.

These wind sites are promising as existing studies indicate the areas experience a steady wind that may be strong enough to support a generation project. The future of these projects will depend on the results of the data collected over the next year.
Homer Electric continues to take a proactive role in maintenance of its electrical system in order to provide the most reliable electric service to its members. The following are a few programs and projects that don’t necessarily make headlines, but they are a vital contribution in Homer Electric’s reliability efforts.

**Commitment to Reliability**

**Cable Injection Project**

Homer Electric continued the 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. In 2008, HEA line crews injected 20,274 feet (3.8 miles) of underground cable. Using this technology can greatly reduce the cost of rebuilding the aging underground system.

**Hazard Tree Removal Program**

Homer Electric has continued with its aggressive tree clearing program to protect facilities and lessen the chance of wildfires. In 2008, tree clearing crews worked in the Sterling, Anchor Point and Homer areas and removed approximately 208 miles of beetle-killed spruce trees outside of the right-of-way. This work, in conjunction with prior years of clearing efforts, has resulted in a significant decrease in the number of tree-related outages in HEA’s service territory. For example, the number of tree-related outages in 2004 totaled 284 outages. With clearing efforts, that number diminished to 92 tree-related outages in 2008.

**Automated Meter Reading (AMR)**

Four years ago, Homer Electric Association made an important decision to install the CANNON Technologies automated meter reading system. The project began with a small sampling of 300 meters in the Kasilof and Kenai substation areas and has grown today to over 24,000 residential single-phase AMR meters in North Kenai, City of Kenai, Beaver Creek, Sterling, Soldotna, Funny River Road, KBeach Road, Kasilof, Ninilchik and Anchor Point areas.

The main reasons for the new metering system was to replace aging mechanical meters and reduce the number of estimated meter readings each month.

In 2008, HEA installed 5,000 meters in portions of Sterling and then from Ninilchik to Anchor Point. Communication equipment in the Anchor Point Substation came on-line around June 2008. Installation work continues today in parts of Homer, as well to the Russian villages and then to communities across Kachemak Bay.

The new CANNON system has changed the way HEA does business. For example, members moving from one location to another need not provide an “in or out” meter reading, as this can be done by the HEA office staff. When a consumer calls to say they are out of power, a quick check from the office determines if there is voltage up to the meter so that the appropriate action can be taken to resolve the outage. Fewer estimated billings have reduced the number of consumer calls and complaints.

**Tree Cable Replacement Project**

In 2008, Homer Electric began the replacement of tree cable between Port Graham and Nanwalek. The rocky terrain offered challenges which were addressed using a rock trencher owned by a local contractor. Approximately 2400 feet of tree cable was replaced.

**Pole Assessment Program**

Homer Electric has started a program to inspect and assess critical power poles in its service territory to ensure its integrity and strength. This assessment program is being spread out over several years to keep the costs reasonable. Inspection involves boring into the power pole at several locations and checking for overall condition, remaining strength, and any insect damage. During 2008, approximately 1,300 poles were inspected, and HEA has started a replacement program for the poles with significant problems.
Homer Electric Association is committed to establishing fair and reasonable electric rates that allow us to provide reliable electricity to our members and our community through superior customer service and innovative energy solutions.

Homer Electric concluded the year 2008 with total consolidated revenues and non-operating income of $81.0 million. That, combined with total consolidated costs of electric service of $74.4 million, resulted in a positive margin of $6.6 million. The following is a financial summary for the year.

**RETAIL SALES**

Homer Electric sold 523.3 million kilowatt-hours of electricity in 2008, a decrease of 1.2 percent from 2007. The relatively flat overall change in sales was a combination of an 11 percent increase in residential and small commercial sales offset by an equal decrease in large commercial kilowatt hour sales.

**REVENUES**

Revenue from energy sales was $69.2 million, up 12 percent from 2007. The revenue growth was primarily attributed to increased residential and small commercial energy sales.

Additionally, Homer Electric benefitted from an approximate $600,000 allocation of patronage capital from our wholesale supplier, Chugach Electric Association.

**KEY RATIO**

HEA’s equity-to-total assets ratio (the accumulated member’s ownership as a percentage of the total value of the utility’s assets) was 33.3 percent at year end, up 0.7 percent from 2007. 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 21.4%. Both ratios are in compliance with our debt covenant requirements and are key indicators the cooperative uses to measure financial performance.

**WHOLESALE POWER COST RATE ADJUSTMENT (WPCRA)**

This is the energy rate component that reflects changes in the cost of purchased power, due primarily to the fluctuating cost of fuel. The wholesale power cost rate adjustment increased from 0.078 cents per kWh on January 1, 2008, to 4.004 cents per kWh on December 31, 2008. This upward trend continued into 2009 when the WPCRA climbed to 7.916 cents per kWh. Throughout 2008 the rate varied greatly resulting in an average WPCRA of 1.384 cents per kWh.

**EXPENSES**

In 2008, total expenses were $74.4 million up $3.4 million from 2007. Purchased Power costs comprised 54 percent of the total costs, the same percentage as in 2007. Operating costs, depreciation expense and interest expense also remained unchanged as a percentage of total expenses.

**CAPITAL CREDITS**

In 2008, the Board of Directors approved the retirement of Estate Capital Credits in the amount of $177,170.

**SYSTEM**

Services in place at year end totaled 30,979, a 2.4 percent increase from 2007. There were 850 new services connected and 126 services retired, resulting in 724 additional services for the year compared to 492 additional services in 2007.

In conclusion, Homer Electric met all of its financial goals in 2008. Nonetheless, the unprecedented rise in the first quarter 2009 WPCRA caused equally unprecedented hardships on our members. WPCRA fluctuations, driven by our significant dependence on the price volatility of natural gas, were highlighted again on April 1, 2009 when the rate declined 50 percent to 3.97 cents per kilowatt hour. Your cooperative will continue to meet the energy needs of our members through innovative energy solutions and strive for the most reasonable rates possible.
Consolidated Statements of Operations & Patronage Capital

Years Ended 2008 and 2007

<table>
<thead>
<tr>
<th>Description</th>
<th>2008</th>
<th>2007</th>
</tr>
</thead>
<tbody>
<tr>
<td>Operating Revenues</td>
<td>$77,452,764</td>
<td>$69,912,396</td>
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<tr>
<td>Operating Expenses:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cost of power</td>
<td>39,914,519</td>
<td>38,303,434</td>
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<tr>
<td>Transmission expense</td>
<td>1,252,998</td>
<td>619,007</td>
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<tr>
<td>Distribution - operations</td>
<td>1,250,435</td>
<td>1,444,878</td>
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<tr>
<td>Distribution - maintenance</td>
<td>3,857,953</td>
<td>4,154,796</td>
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<tr>
<td>Production - maintenance</td>
<td>578,715</td>
<td>499,487</td>
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<td>Consumer accounts</td>
<td>2,849,088</td>
<td>2,784,369</td>
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<td>Customer service &amp; information</td>
<td>278,391</td>
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<td>Sales expense</td>
<td>121,528</td>
<td>114,759</td>
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<td>Administrative and general</td>
<td>6,657,575</td>
<td>5,826,348</td>
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<tr>
<td>Depreciation and amortization</td>
<td>8,499,555</td>
<td>8,021,663</td>
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<td>Taxes</td>
<td>260,743</td>
<td>267,540</td>
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<td>Miscellaneous</td>
<td>167,504</td>
<td>195,205</td>
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<tr>
<td>Total operating expenses</td>
<td>65,699,384</td>
<td>62,537,986</td>
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</table>

Operating margins before fixed charges            | 11,853,380 | 7,374,410  |

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<thead>
<tr>
<th>Description</th>
<th>2008</th>
<th>2007</th>
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<tbody>
<tr>
<td>Fixed charges</td>
<td></td>
<td></td>
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<tr>
<td>Interest on debt</td>
<td>8,803,795</td>
<td>8,444,003</td>
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<tr>
<td>Allowance for borrowed funds used during construction</td>
<td>(566,370)</td>
<td>(276,918)</td>
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<tr>
<td>Total fixed charges</td>
<td>8,238,425</td>
<td>8,167,085</td>
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Operating margins (loss) after fixed charges       | 3,614,955  | (792,675)  |

<table>
<thead>
<tr>
<th>Description</th>
<th>2008</th>
<th>2007</th>
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<tbody>
<tr>
<td>Patronage capital allocation</td>
<td>1,837,132</td>
<td>1,217,113</td>
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<tr>
<td>Net operating margins</td>
<td>5,452,087</td>
<td>424,438</td>
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Non-operating margins:                             |            |            |
| Interest income                                  | 1,200,521  | 2,190,033  |
| Other income (expense)                           | 6,031      | 119,657    |
| Total non-operating margins                      | 1,206,552  | 2,309,690  |

Net margins                                      | 6,658,619  | 2,734,128  |

<table>
<thead>
<tr>
<th>Description</th>
<th>2008</th>
<th>2007</th>
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<tbody>
<tr>
<td>Patronage capital - beginning of year</td>
<td>53,195,628</td>
<td>51,183,575</td>
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<tr>
<td>Less retirement of patronage capital credits</td>
<td>(177,596)</td>
<td>(276,918)</td>
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<tr>
<td>Patronage capital - end of year</td>
<td>59,876,651</td>
<td>53,159,628</td>
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Customer Satisfaction Survey

For a three month period of time from April to July 2008, Homer Electric conducted a customer satisfaction survey to provide a baseline of information for how HEA can better serve members’ needs. The short questionnaire was printed in post-card style and was distributed to members who either called on the telephone or visited one of the HEA offices during that period.

Of the over 3,500 questionnaires distributed, 491 were returned, representing 2% of HEA’s membership. Amazingly, 94.4% of respondents were satisfied with the results of their recent interaction with Homer Electric’s staff and 93.9% reported that their problem was handled timely and professionally. Overall, 51.6% of the respondents rated their experience as “Exceeds Expectation,” while 11.6% felt that overall it could have been better. “This data is just the motivation we need to continue our pursuit of excellence,” said Sandra Ghormley, Manager of Member Services.

The survey will be conducted again during the same period this year to determine if internal improvements made during the year resulted in higher customer satisfaction scores.

In Remembrance

Homer Electric remembers Shane Harrington, a special member of the HEA family, who will be greatly missed. Shane worked at HEA for four years.

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:

Rick Porter, Information Services System Analyst/Programmer - retired after 30 years at Homer Electric.

Dan Irmen, Senior Apparatus & Metering Technician - retired after 23 years.

Shareen Bock, Member Services Specialist - retired after 18 years.

Jean Schroeder, Administrative Assistant - celebrated her 20-year anniversary of HEA employment.

Tamara Fletcher, Purchasing & Materials Management Supervisor - celebrated her 10-year anniversary.

Randy Parrett, Senior Apparatus/Metering Technician - celebrated his 10-years with Homer Electric.

Jim Patras, Regulatory Affairs Coordinator - celebrated his 10-year anniversary.