VISION | COMMITMENT | VALUE

2009 ANNUAL REPORT

Balancing today's opportunities with tomorrow's needs

Homer Electric Association, Inc.

A Touchstone Energy® Cooperative

On behalf of the Board of Directors of Homer Electric Association, we would like to say thank you to our members for their continued support during a very eventful year. During 2009, the cooperative saw a large fluctuation in energy prices, embarked on major construction projects, launched energy conservation programs, held community meetings, planned for future power generation, and kept the lights on for members around the Kenai Peninsula.

The Board of Directors and management staff are privileged to be part of this exciting period in HEA's history. As we move forward, continued input and feedback from our membership will be more important than ever to ensure the right steps are taken. The Board of Directors and staff are committed to making sure that we carefully weigh all the options before us and that the best interests of our members are always protected.

While there are a number of issues to deal with, we would like to focus on a few that we believe are vitally important to the future success of HEA.

GENERATION PLANS

During 2009, it became painfully clear how the price of natural gas can control the rates charged by HEA and other Railbelt utilities. In January of 2009, the wholesale power cost rate adjustment, which reflects changes in the price of natural gas, increased dramatically. The result was a steep increase in the electric rate for HEA members. The impact on our members was widespread and created hardship for many people. Fortunately, natural gas prices started to decline and by the middle of the year we started to see energy rates come back to earlier levels.

While HEA cannot control the price of natural gas, we can start to take a more proactive approach to our generation needs. In 2007, the HEA Board determined that it would not renew its current power supply contract with Chugach Electric when it expires on December 31, 2013. This is a major change in direction for the cooperative which has been purchasing most of its power from Chugach Electric since 1963.

Brad Janorschke, General Manager

After careful consideration of various power supply options, the Board and staff have determined that Homer Electric members will be best served by the cooperative owning its own generation facilities. Our proposal, Independent Light, will consist of adding a steam turbine at our Nikiski Generation Plant and installing two, gas-fired turbines at the HEA substation in Soldotna. This project will allow HEA to take care of its own generation needs while still staying connected to the Railbelt grid, make good use of existing HEA assets, create additional jobs on the Kenai Peninsula, and improve the ability to integrate renewable energy into the HEA system.

Deborah Debnam, President

As we move forward in 2010, we will continue to develop the details of Independent Light. Through careful planning and wise use of our resources, HEA is well positioned to be energy independent in 2014.

RENEWABLE ENERGY

Adding renewable energy to HEA's energy portfolio is a priority for Homer Electric. In 2009, extensive studies were undertaken to investigate the potential of several small hydroelectric sites on the Kenai Peninsula. While the studies found that some of the sites would not be economically viable, others will continue to be considered.

In addition to small hydro, HEA is looking at purchasing wind power. Kenai Winds is a project that would produce power from wind turbines located along the bluff in Nikiski near the former Agrium plant. HEA is in discussion with the developers of Kenai Winds and optimistic that a power purchase agreement can be reached.

One of the most encouraging steps in renewable energy in 2009 was the addition of 20 small, member-owned projects. HEA members, working with our engineering staff, have connected wind turbines and solar panels to their homes, producing over 13,000 kilowatt hours of energy from alternative energy generation sites!

It really has been a remarkable year and we are so proud of all the accomplishments of our members and the cooperative. As long as we continue to work together, there is no doubt that we will be successful.

In closing, it is with sadness that we recognize the passing of long time HEA Board member Ruth Fitzpatrick of Kenai. We are honored to have had Ruth serve on the HEA Board for several years and admired her dedication and commitment to the members of HEA. She was a valued member of the HEA family and will be greatly missed.

Homer Electric Association faced many challenges in 2009 on a wide variety of fronts. In a climate of business closures, declining electric sales, fewer new services constructed, and a volatile natural gas market, HEA's management and Board of Directors maintained a steady, determined focus; one that is committed to providing members the best service possible at a reasonable price.

ECONOMIC CHALLENGES

It was not surprising that Homer Electric's kilowatt hour sales fell 7.68% from the previous year. We know from the local news that our communities were impacted by the closure of several local businesses and subsequent job losses. Over the last three years, there has been a steady decline of new services. Early in 2009, escalating natural gas prices resulted in a steep increase in the price of electricity for Homer Electric members. The increase in natural gas prices directly affected the wholesale power cost rate adjustment (WPCRA) which ultimately impacted the overall energy rate by 20 percent for average members using 630 kilowatt hours in January 2009. Even with HEA's decrease in the base energy rate in July of 2009, that decrease was still off-set by an upward adjustment in the WPCRA.

There will always be factors beyond Homer Electric's control such as the price of fuel and economic downturns. In spite of these challenges, Homer Electric has added value to your membership in 2009. The board and management is committed to being proactive not only ensuring future electric generation needs are met, but at the same time providing reliable, affordable energy for our members today.

BALANCING TODAY'S OPPORTUNITIES WITH TOMORROW'S NEEDS

In order to provide the most reliable and affordable power to our members, Homer Electric focused on diversifying our sources of electric generation. Balancing resources available today with keeping tomorrow's needs in mind, Homer Electric explored the following generation resources.

Homer Electric reviewed the feasibility of alternative power sources such as small scale hydro project sites on the Kenai Peninsula, a pilot project to test a tidal power system in Kachemak Bay, and the possibility of wind power produced on the Kenai Peninsula.

In addition, an area that members and the cooperative *can* manage is energy conservation. HEA encouraged the enrollment in HEA's renewable energy incentive program called Sustainable Natural Alternative Power (SNAP), continued to work with local legislators to introduce Net Metering, launched the WiseWatts conservation program and hosted its first annual Energy & Conservation Fair. More than 700 people attended the event.

SMALL HYDRO PROJECTS

HEA continued to refine its focus on renewable small hydropower in 2009. HEA is now the sole owner of Kenai Hydro, LLC (KHL) which is the holder of the Federal Energy Regulatory Commission (FERC) preliminary permits for the small hydro sites.

In 2009, KHL surrendered its permits for the Crescent Lake and Ptarmigan Lake projects, determining that the projects were not economically feasible at this time. The Falls Creek project was being considered by KHL as a complementary element of the Grant Lake project, but after weighing the benefits and costs, as well as public input gathered as a result of the licensing process, KHL has decided to eliminate Falls Creek from the project scope. KHL will continue to pursue the Grant Lake project and is currently in the pre-licensing FERC process.

Grant Lake is approximately 1-mile east of the Seward Highway and is hidden from view by a ridge separating it from the adjacent community of Moose Pass. The project is sized at 4.5 megawatts. While this project may be considered small to some, it could make a big difference to HEA members. This facility could provide up to 40% more renewable energy than HEA currently enjoys from its share of the Bradley Lake hydro power!

In 2010, KHL will continue its progress toward a FERC license application in the fall of 2011. For the latest news pertaining to the project, visit the KHL licensing web site at www.kenaihydro.com.

TIDAL POWER RESEARCH

Another avenue Homer Electric pursued called for a pilot project to test a tidal power system in Kachemak Bay. Unfortunately, economic hurdles forced Homer Electric to indefinitely postpone the project. HEA will continue to keep abreast of tidal information and potential partnering possibilities in the area.

WIND POWER POSSIBILITIES

In addition to researching small hydro and tidal power, there is a possibility of seeing wind power produced on the Kenai Peninsula. Kenai Winds, a private renewable energy company, has pending plans for a wind farm in the Nikiski area. This power would be available to Homer Electric and be a unique addition to our energy portfolio.

COMMITMENT TO RELIABILITY

Homer Electric continues to take a proactive role in maintenance of its electrical system in order to increase reliability of electric service to its members. The following are a few projects that don't necessarily make headlines, but they are a vital contribution in Homer Electric's commitment to reliability.

HAZARD TREE REMOVAL PROGRAM

Homer Electric has continued with its aggressive tree clearing program to protect facilities and lessen the chance of wildfires. In 2009, tree clearing crews worked in the Kasilof, Anchor Point, Homer, Seldovia and Bradley Lake areas and removed approximately 130 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 86 tree-related outages in 2009.

CABLE INJECTION PROJECT

Homer Electric continues to address the concerns of aging underground cable in the utility's distribution system. There are two options available to us: replacement or cable rejuvenation. Since the implementation of the Underground Replacement/Rejuvenation Plan in 2008, HEA has replaced 10,000 feet of conductor and rejuvenated 40,187 feet of old conductors. Cable injection has proven to be a great tool for extending the life of a cable.

Cable injection is a new technological process that involves the injection of a rejuvenation fluid into aging underground conductor wire. The average life for underground cable is 20 years. The injection process provides an additional 40 years of longevity to underground conductor wire.

Homer Electric has more than 42 miles of underground conductor wire installed more than 20 years ago; exceeding its useful life span. Cable injection offers a means for extending the life of underground cable without enduring costly replacement expenses.

In 2007, Homer Electric worked together with Novinium, the vendor for this technology, to implement an injection plan designed to address the demands of an aging distribution system and improve reliability. Entering the fourth year, HEA linemen have received certification in the injection process and have significantly increased productivity using this technology. Costs have been reduced by as much as one-half from 2008 to 2009. There is 7.6 miles of injected underground conductor wire that now has an extended life of 40 more years based upon the warranty provided by Novinium.

Cable injection has proven to be a viable cost saving measure for Homer Electric and its members. The 2010 HEA Construction Work Plan includes funds to continue to implement the plan for cable injection and underground replacement.

AUTOMATED METER READING (AMR)

In 2009, HEA completed the final year of a five-year program to install over 27,000 automated meters (AMR) in our service territory. Benefits to members include reduced estimated meter readings which resulted in fewer billing adjustments for members. The new AMR software also provides HEA staff real-time meter information to assist members with understanding their energy usage and the software has proven useful in power outage restoration. An added benefit of AMR meters communicating with HEA offices through the power lines is that it reduces the need for manually reading meters, and consequently, results in lessening HEA's carbon footprint on the environment.

LOCAL RENEWABLE ENERGY

Homer Electric's Sustainable Natural Alternative Power program, called SNAP, makes small-scale solar, wind, geothermal or biomass power more cost-effective for owners. The program connects member/owners who want to produce alternative power with other local members who want to support the development of local, renewable energy.

To date, Homer Electric has 26 renewable interconnections. Of those interconnections, 20 are SNAP Producers. There are 19 wind installations and seven solar installations connected to the HEA grid.

Keeping its eye on the future and commitment to add value, HEA's board and management took a proactive stand to offer this eco-friendly, renewable power program to its membership until new net metering regulations are enacted.

DIAMOND RIDGE SUBSTATION

The construction of the new Diamond Ridge Substation, a transmission and distribution substation in Homer, has created another source for 24.9 kV power to the Homer grid and will improve reliability to the area. Construction of the new Diamond Ridge Substation was completed internally and both the distribution switchgear building and transmission control building were commissioned by a joint team of HEA and Power Testing & Energization (consultant) technicians and engineers prior to the end of 2009.

The remaining work, which involves re-configuration of the 115 kV and 69 kV transmission lines, relocation of the 115/69 kV transformer to the new station, and demolition of the existing substation, will be completed in steps. The first step involves the section coming in from Fritz Creek/Bradley Lake and the next step involves moving the distribution loads over to the new station. The new Diamond Ridge station has both replaced the old station and also provides a second source for distribution in addition to Hatfield Substation. The project is expected to be completed in spring of 2010.

MARATHON TRANSMISSION LINE

The construction of the Marathon Transmission Line in 2009 completed a long needed tie between Marathon Substation and Bernice Lake Substation. Construction was manned and completed with HEA line crews out of the Kenai Service Center which contributed to the job being completed 25% under budget. The construction of the line took place in two different stages. The first phase of construction consisted of two miles of line being built on the north end of the project in the winter months of 2008. The second phase of construction consisted of six miles of line completed in the winter months of 2009.

COMMITMENT TO CONSERVATION AWARENESS

One of the ways we, as consumers, can control our electric costs is being aware of our electric consumption. As the demand and cost for electricity increases, it is more important than ever to become more energy efficient and conscious.

As part of Homer Electric's ongoing energy conservation efforts to provide energy conservation information and tools to its members, the WiseWatts energy conservation program was formally launched in 2009. Last year's WiseWatts program included the following elements and events.

Homer Electric hosted its first annual Energy and Conservation Fair in Kenai and in Homer last year. The events focused on sensible energy solutions and local businesses and organizations were on hand to disseminate information on the latest technologies, programs, and products to help members learn more about their energy consumption options. The fairs featured more than 20 local vendors with expertise in the areas of energy-saving devices and techniques. The benefit to co-op members was that this information could be found in one location at one time. The Energy & Conservation Fairs were a huge success with more than 700 people attending both events.

There is a monthly WiseWatts energy conservation news article in the member newsletter, The *Kilowatt Courier*, featuring everyday energy savings tips for households.

Homer Electric also offered *Kick inCan*, a campaign to conserve energy by switching to compact fluorescent light bulbs (CFL). Members were offered five CFL in exchange for turning in five incandescent light bulbs. Local agencies partnered with HEA to distribute and collect the bulbs and the program was a great success. HEA distributed 7,000 CFL to HEA members last year through Salvation Army stores, Kenai Peninsula Food Bank, Homer Food Pantry, Ninilchik Traditional Council, Seldovia Village Tribe, Port Graham Village Council and Nanwalek IRA Council.

Another means of providing energy conservation incentive to its members was offering the gift of 12 CFL bulbs to members who enrolled in Homer Electric's EasyPay online e-payment service. More than 400 members took advantage of this convenient service in 2009. The program successfully reduced paper handling costs and at the same time saved members electric energy.

MEMBER RECEPTION & MEMBER SERVICE AREA UPDATED

Homer Electric has updated its member service area in the Homer office in an effort to provide a more private and secure setting to conduct your HEA business. To accommodate members' privacy needs, the new member service area features a welcoming reception area, two member service counters and a desk to conduct new service/construction business with HEA's engineering department.

VISION/COMMITMENT/VALUE

Although 2009 presented many challenges, your cooperative continues to provide service that you can rely upon. A clear vision to meet future needs, balanced with a commitment to add value to your Homer Electric membership, the board of directors and management ended the year prepared to seize any new business opportunity that will improve the services provided and reduce costs.

Homer Electric Association is committed to establishing electric rates that allow us to provide reliable electricity at fair and reasonable prices to our members.

Homer Electric concluded the year 2009 with total consolidated revenues and non-operating income of $89 million. That, combined with total consolidated costs of electric service of $86.7 million, resulted in a positive margin of $2.3 million. The following is a financial summary for the year.

RETAIL SALES:

Homer Electric sold 483.1 million kilowatt-hours of electricity in 2009, a decrease of 7.7 percent from 2008. The significant decline in kilowatt hour sales was due to a decline in all rate classes with the largest decline of 20% coming from the large industrial class.

REVENUES:

Revenue from energy sales was $79.1 million, up 14 percent from 2008. Given the kilowatt hours sales declined in all classes and there was a net .01% decrease in base rates, the increase in revenue was due entirely to passing through the increased cost of power in the wholesale power cost rate adjustment (WPCRA).

KEY RATIOS:

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 32.3 percent at year end, down 1.0 percent from 2008. 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 25%. Both ratios are in compliance with our debt covenant requirements and are 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 by the fluctuating cost of fuel. The wholesale power cost rate adjustment decreased from 7.916 cents per kWh on January 1, 2009, to 1.966 cents per kWh on December 31, 2009. This fluctuating trend continued into 2010 when the WPCRA decreased to .181 cents per kWh on January 1. Throughout 2009 the average WPCRA was 4.57 cents per kWh.

EXPENSES:

In 2009, total expenses were $86.7 million up $12.3 million from 2008. Purchased power costs increased $9.8 million and comprised 57 percent of the total costs, up 4% over 2008. Operating costs, depreciation expense and interest expense declined 4% from 2008 as a percentage of total expenses.

CAPITAL CREDITS:

In 2009, the Board of Directors approved the retirement of General Capital Credits in the amount of $2 million and Estate Capital Credits in the amount of $248,643.

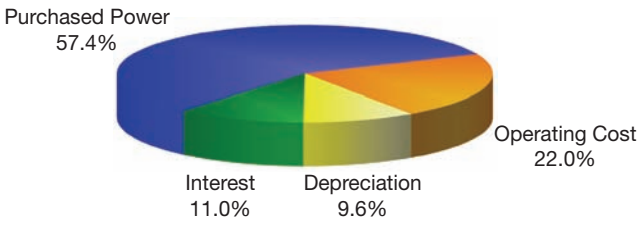
SYSTEM:

Services in place at year end totaled 31,456, a 1.5 percent increase from 2008. There were 601 new services connected and 124 services retired, resulting in a net increase of 477 for the year compared to 724 in 2008.

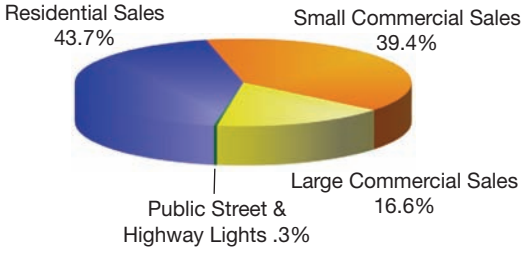
In conclusion, Homer Electric met all of its financial goals in 2009. Meeting goals of sound financial management of your cooperative allows HEA to continue to meet the energy needs of our members through innovative energy solutions, ensuring as fair and reasonable rates as possible.

David B. Thomas, Treasurer

EXPENSES



RETAIL SALES



Homer Electric Association, Inc. and Subsidiary
Consolidated Balance Sheets
December 31, 2009 and 2008

ASSETS	2009	2008
UTILITY PLANT, at cost:		
Electric plant in service	$275,866,788	$270,488,791
Electric plant held for future use	21,700,695	3,856,035
Construction work in progress	15,290,488	20,676,346
Total utility plant, at cost	312,857,971	295,021,172
Less accumulated depreciation & amort.	(118,024,954)	(111,044,481)
Net utility plant	**194,833,017**	**183,976,691**
OTHER ASSETS AND INVESTMENTS:		
Investment in assoc. organizations	16,820,587	17,434,170
Other investments	215,437	223,566
Notes receivable	996,290	976,311
Non-utility property, net of accum. depreciation of $263,763 ($228,067 in 2008)	503,501	537,940
Total other assets and investments	**18,535,815**	**19,171,987**
CURRENT ASSETS:		
Cash and cash equivalents	9,821,389	27,560,871
Accounts receivable, less allowance for doubtful accounts of $91,466 ($82,685 in 2008)	5,850,532	6,995,797
Unbilled revenue	3,532,292	3,041,625
Materials, fuel, and supplies inventory	3,892,064	4,135,262
Notes receivable, current portion	360,000	461,000
Other current and accrued assets	413,029	738,973
Total current assets	**23,869,306**	**42,933,528**
DEFERRED CHARGES	**16,325,837**	**11,992,052**
Total assets	**$253,563,975**	**$258,074,258**

EQUITIES & LIABILITIES	2009	2008
EQUITIES AND MARGINS:		
Memberships	$70,000	$73,570
Patronage capital	59,776,812	59,676,651
Other equities - donated capital	2,344,228	2,115,727
Total equities and margins	**62,191,040**	**61,865,948**
LONG-TERM DEBT:		
NRUCFC mortgage notes	**152,774,977**	**148,257,837**
CURRENT LIABILITIES:		
Current portion of long-term debt	6,281,531	5,764,314
Line of credit	-------	3,000,000
Accounts payable	5,920,320	6,096,507
Consumer deposits	1,020,630	1,006,062
Accrued payroll and benefits	1,797,724	1,544,635
Accrued taxes and other current liabilities	739,721	824,610
Total current liabilities	**15,759,926**	**18,236,128**
DEFERRED CREDITS	**22,838,032**	**29,714,345**
Total equities and liabilities	**$253,563,975**	**$258,074,258**

Consolidated Statements of Operations & Patronage Capital
Years Ended 2009 and 2008

	2009	2008
Operating Revenues	**$87,283,352**	**$77,452,764**
Operating Expenses:		
Purchased power costs	49,762,798	39,914,519
Transmission expense	1,104,527	1,252,998
Distribution - operations	1,395,001	1,250,435
Distribution - maintenance	4,456,800	3,857,953
Production - maintenance	653,097	578,715
Consumer accounts	3,008,364	2,849,088
Customer service and information	383,227	278,391
Sales expense	142,931	121,528
Administrative and general	7,440,164	6,657,575
Depreciation and amortization	8,389,082	8,409,935
Taxes	239,522	260,743
Miscellaneous	463,395	167,504
Total operating expenses	**77,438,908**	**65,599,384**
Operating margins before fixed charges	**9,844,444**	**11,853,380**
Fixed charges:		
Interest on debt	9,292,260	8,803,795
Allowance for funds used during construction	(541,968)	(565,370)
Net fixed charges	**8,750,292**	**8,238,425**
Operating margins after fixed charges	1,094,152	3,614,955
Patronage capital allocation	534,967	1,837,132
Net operating margins	**1,629,119**	**5,452,087**
Nonoperating margins:		
Interest income	688,483	1,200,521
Other income	31,534	6,011
Total nonoperating margins	**720,017**	**1,206,532**
Net margins	**2,349,136**	**6,658,619**
Patronage capital at beginning of year	59,676,651	53,195,628
Less retirement of patronage capital credits	(2,248,975)	(177,596)
Patronage capital at end of year	**$59,776,812**	**$59,676,651**

IN DEDICATION & REMEMBRANCE

BILLY D. THOMPSON SUBSTATION

April 25th, 2009 marked the dedication day of the Billy D. Thompson Substation (formerly the Ski Hill Substation) in Soldotna. The substation was renamed to honor long-time employee, Billy Thompson. Billy worked at HEA for 26 years and was the Superintendent in Kenai. He retired in 2004.

Director Tim Evans with Marita Thompson, lineman Dean Glick, and Director Debbie Debnam.

GERRY WILLARD GENERATION PLANT

In the fall of 2009, Homer Electric dedicated and renamed its Seldovia Plant to honor long-time HEA employee, Gerry Willard. Before his retirement, Gerry worked for Homer Electric for 24 years providing service as the Area Service Coordinator to Seldovia and then for 3 years as the Safety Coordinator. After 27 years of dedicated service, Gerry retired, only to return a few months later to provide part-time service to his community and Homer Electric as a Part-Time, Power Plant Operator.

Both Billy Thompson and Gerry Willard were special members of the HEA family and will be greatly missed.

Gerry Willard's son Kenny Willard, granddaughter Ginger Moffitt, and sister Kathryn Willard.

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:

- Karen Dusenbery, Meter Reader in Homer, retired after 29 years of employment with Homer Electric.
- Rick Eckert, Fuel Procurement/Ancillary Services Manager, celebrated his 20-year HEA anniversary.
- Karen Fann, Projects Administrator, celebrated her 20-year anniversary with Homer Electric and retired.
- Duane Parlow, Director of Administrative & Member Services, retired after 14 years with Homer Electric.
- Cindy Hays, Service Operations Clerk, celebrated her 20-year anniversary of employment.
- Carrie Buckley, Director of Finance, celebrated 10 years of employment at Homer Electric.

BOARD OF DIRECTORS

Homer Electric Association, Inc.

A Touchstone Energy® Cooperative