MESSAGE from the President & General Manager

We are pleased to provide this annual report to the Homer Electric Association, Inc. (HEA) membership summarizing your cooperative’s accomplishments and operations over the prior year. As a member of HEA, you have an influence over how your cooperative is run because membership equals ownership. Being not-for-profit, locally owned and operated, and democratically run means HEA exists to focus on its members’ needs. HEA was created to provide its members affordable, reliable energy, which remains our number one goal. As a not-for-profit cooperative, HEA’s priorities are local and decisions are weighed based on what is best for our community. To realize those priorities, HEA strives to improve its members’ quality of life by taking leadership roles in community development projects, educating youth, and generously donating time and resources to schools, nonprofits and community events.

In addition, as a not-for-profit, HEA provides electricity to our members at cost and “a little bit extra” to build equity and satisfy our lender’s requirements. Eventually this “little bit extra” is returned to our members as capital credits. In April 2017, HEA refunded capital credits for members that paid the “little bit extra” during the years 1986 and 1987, totaling $1,500,000.

HEA is more than just a utility provider that you pay each month for electricity. We are committed to building even stronger connections with you and the local communities we serve. We stand ready to provide you with information, resources and services that are as reliable and useful as the electricity we supply. We want you to view HEA as your trusted energy partner and your first stop whenever you have a question about any issue related to electric energy. We encourage you to contact our helpful member support representatives for any of the following:

- Energy efficiency tips and recommendations;
- The latest renewable energy information and facts;
- New service and billing inquiries; and
- Any concerns or questions about your electrical safety needs.

On behalf of the Board of Directors and staff of HEA, we thank you for your loyalty and interest, and encourage your participation in all that HEA has to offer the residents of the Kenai Peninsula.

Mission Statement:
To safely provide reliable electricity to our members and our community through superior customer service and innovative energy solutions at fair and reasonable prices.
WE THE PEOPLE:
Your Member-Owned Cooperative

The first three words in the Constitution are the most powerful. “We the People...” That preamble of the Constitution declares that the power is derived, not from a government, but by the people itself. Much like a cooperative is powered by its members.

The principles behind the Constitution and Declaration of Independence that form the basis of American democracy also form the basis of cooperatives. A cooperative is owned and democratically controlled by the people who use its services. Each member has one vote regardless of their stake; that is, some members cannot buy more control than anyone else. This stands in stark contrast to investor-owned businesses where only shareholders have a vote in how the business is run; and even among shareholders, some have more votes than others depending on their shares of stock.

You, as a member of Homer Electric Association, Inc. (HEA), belong to a member-owned, not-for-profit cooperative.

The Declaration of Independence declared the equality of rights of its citizens and that people had the right to organize to secure their futures. At the time the Declaration was written, democracy was an untested idea — but the founders of our country were determined to make it work.

So when you celebrate the many liberties and rights we enjoy with our families and friends over the years, think about those principles that inspired our Founding Fathers. They also inspired the pioneers who established electric cooperatives—folks who were determined to provide safe, reliable, and affordable power to secure the futures of rural communities. HEA has always operated under the principles of democracy, and we are dedicated to fulfilling that promise as we serve members today and in the future.

In turn, our members must realize they are empowered and encouraged to actively participate in determining the future of our cooperative. Be informed. Attend HEA meetings. Visit the website. Follow us on Facebook. Read the member newsletter. Vote for your Board of Directors. Cooperative ownership begins in the hands of we, the people.

Seven Cooperative Principles:
- Voluntary and Open Membership
- Democratic Member Control
- Members’ Economic Participation
- Autonomy and Independence
- Education, Training and Information
- Cooperation among Cooperatives
- Concern for Community

2016 YEAR IN REVIEW
Significant highlights from 2016

Power Sales Agreement
Contributes to Healthy Co-op Forecast

In April 2016, HEA negotiated and executed a five-year power sales agreement with Tesoro, one of the cooperative’s largest industrial customers.

This agreement ensures a healthy supply and demand for your cooperative.

Local Control

In 2016, the most significant example of HEA members’ influence and voice of the cooperative’s direction was the results of the 2016 special election. HEA was very pleased with the membership voter turnout - almost one third of the membership voted on this important member decision. Members voted to remain under the oversight of the Regulatory Commission of Alaska, the agency that oversees the pricing practices of public utilities in Alaska.

Results were as follows:
- 31.7 percent of HEA members returned ballots
- 2,042 voted to withdraw from RCA oversight
- 4,854 voted to remain under RCA oversight
Bradley Lake Hydroelectric
Debris Removal Project

Another significant project in 2016 was the removal of fish water screen debris at Bradley Lake. Pipes with birdcage type inlet screens are located in the bottom of Bradley Lake Dam Diversion Tunnel inlet. The fish water pipes are used to bypass water from the lake to the head of the Bradley River for fish support.

- Over the past 19 years, rock and earth sediment from the dam face had buried one of the screens thereby preventing normal water flow.
- The project entailed reducing Bradley Lake level to 1,068 feet (normal lake minimum level is 1,080 feet) to enable access to the diversion tunnel inlet area.
- Upon gaining access, heavy equipment successfully removed the debris from the screens and the twenty-year-old screens were replaced.

South Kachemak Bay
Generator Replacement Project

To ensure that South Kachemak Bay residents are not left without power for an extended period, HEA has two standby generators located at the Gerry Willard Generation Plant in Seldovia. The two generators are available to supply power to the South Kachemak Bay area when grid power from Homer is out of service. The existing back up generation system is in dire need of replacement. In 2016, HEA completed the design of the upgrades to the Seldovia facility. The project work is scheduled to begin and be completed during the 2017 construction season.

Nikiski
Combined Cycle Maintenance Project

Reliability is a top priority and a major component to HEA’s mission. Every four years, HEA performs major inspections on the Nikiski Combined Cycle (NCC) Plant as reliability is the driving force of these maintenance cycles.

- In 2016, a major disassembly, inspection and overhaul of the combustion turbine, generator and load gear took place, requiring the plant to go offline for almost 4 weeks beginning September 26, 2016.
- The overhaul was successfully completed on schedule and it went back online on October 22, 2016.
System Upgrades & Maintenance

Along with the daily line maintenance and outage responses, HEA line crews accomplished the following projects in 2016.

Moose River Flats
115kv Transmission Pole Replacements

HEA completed a two-year project in which HEA replaced failing transmission structures that were located east of the East Moose River in the Kenai Wildlife Refuge.

Fuse Coordination Project

The Fuse Coordination Project is a multi-year system improvement project intended to reduce the number of outages on our system. The scope of the project is to re-coordinate all fuses on the Homer Electric system. Also included in the project will be the replacement of all aging fuse line cutouts that have had a large failure rate causing numerous power outages in recent years. In 2016, five circuits were completed throughout the system.

Replacement of Bear-Damaged Poles

HEA crews completed a pole replacement project that replaced bear-damaged poles with new fiberglass poles located from McKeon Flats to the China Poot area. Crews also replaced damaged poles in the Neptune Bay and Big Tutka Bay areas.

Underground Cable Injection

HEA crews worked on injecting aging underground cable at various locations on the north end of the system. The cable injection process has proven to be a cost effective and efficient alternative to the expensive process of replacing aging cable.

Breaker and Recloser Projects

HEA crews replaced two 115 kilovolt (kV) breakers at the Soldotna Substation as well as two 69 kV breakers at the Hatfield Substation in Homer. The breaker replacement project will increase reliability of the transmission line that ties HEA’s system to the rest of the Railbelt. HEA also replaced two 12.4 kV reclosers at the Fritz Creek Substation east of Homer.

Grant Lake Hydroelectric Project Update

On April 18, 2016, after nearly eight years of study, consultation, collaboration, and engineering design, the Final License Application for the Grant Lake Hydroelectric Project has been filed with the Federal Energy Regulatory Commission (FERC). FERC anticipates making a decision early in 2018.
Cooperative Spirit
Starts With Employees

HEA employees contribute and volunteer their time to a host of other community efforts throughout the year. HEA takes pride in its team of professional and community-minded employees. Thank you for making a difference in our communities!

Commitment To Service & Community

Homer Electric takes pride in providing several community outreach programs for our community and our local youth each year to promote higher education, cooperative principles, energy conservation, and electrical safety. These programs include academic scholarship awards, an all-expense paid trip to the Idaho Youth Rally, and an electrical safety poster contest.

In addition to providing educational opportunities to our local youth, one of your cooperative’s goals is to keep our members informed and educated on key industry developments, cooperative topics, electrical safety and outage notification. Whether it is through our presence at energy forums, safety presentations in the schools, community outreach programs, well attended HEA area meetings, newsletter, advertisements, Facebook posts, HEA website or through day-to-day conversation with members – HEA is committed to keeping our members informed.

Employee Retirements in 2016

Congratulations to the following employees who have served our membership over many years in the office, in the field, and behind the scenes.

Susan Saxton Retired after nearly 25 years of service
Joe Gallagher Retired after 14 ½ years of service
Stephen J. Pollack Retired after 14 ½ years of service

Anniversaries

Beth Wythe 30 years
Bob Day 10 years
Mike Dunn 10 years
Preston Hanner 10 years
Dale Marsengill 10 years
Paul Rauch 10 years
Trish Wilson 10 years
Brad Zubeck 10 years

Cooperative Spirit
Starts With Employees

HEA employees contribute and volunteer their time to a host of other community efforts throughout the year. HEA takes pride in its team of professional and community-minded employees. Thank you for making a difference in our communities!
Treasurer’s 2016 ANNUAL REPORT

Organized as a rural electric cooperative, Homer Electric Association Inc. operates as a not-for-profit entity. Established by the members to provide service at the lowest possible cost, any excess revenue (or margin) is used to improve service before it is eventually returned to its members in the form of capital credit retirements. Homer Electric takes this commitment to our members seriously. Our number one priority is to establish electric rates that allow us to provide reliable electricity safely and at fair and reasonable prices to you, our members.

In 2016, Homer Electric’s financial position remained stable as we continued to work through the challenging regulatory and Railbelt environments. We diligently monitor and contain costs, while increasing equity to meet financial obligations required by our lenders. We are successfully managing our debt and have decreased our long-term debt by almost $14 million in 2016.

Homer Electric concluded the year 2016 with total consolidated revenues and non-operating income of $98 million. That total less consolidated costs of electric service of $91 million, resulted in a positive margin of $7 million. The following is a financial summary for the year.

System

In 2016 there was a net increase of 183 services, bringing the total to 33,662 services.

Energy Sales

Homer Electric sold 457 million kilowatt-hours of electricity in 2016, which is a decrease of three percent compared to the year 2015. Kilowatt-hours (kWh) sold for all classes of members experienced a decrease, with the largest decrease of seven percent coming from general service sales.

Revenues

Revenue generated from energy sales totaled $95 million, a decrease of almost two percent from the previous year. In 2016, Homer Electric also received $1.2 million in revenue from power sales to other electric utilities.

Rate Changes

As of December 31, 2016, interim rates were in effect as Homer Electric was undergoing a rate case with the Regulatory Commission of Alaska (RCA). For residential members the customer charge was $15.49 and the base energy rate was 15.37 cents/kWh. These charges on your bill recover administrative and customer service costs, as well as pay for distribution, generation, and transmission systems in place to provide reliable electricity. On January 5, 2017, the new RCA approved rates went into effect increasing the customer charge to $20.00 and decreasing the base energy rate to 14.87 cents/kWh for residential members.

The cost of fuel and other sources of power that are used to generate your electricity is reflected on your bill as the Cost of Power Adjustment (COPA) charge. This rate is adjusted quarterly primarily based on the cost and source of fuel used. The average COPA rate in 2016 was 6.6 cents/kWh.

The average residential member uses 550 kWh per month. Here is the breakdown for a monthly bill based on the rates in effect at the end of the last three years, plus the new rates effective as of April 1, 2017.

Where Your Dollar Went

Expenses

In 2016, total expenses were $91 million, down $2 million or about two percent compared to 2015. Fuel and purchased power costs decreased by $2.3 million and comprised thirty-seven percent of total expenses. Operating costs, depreciation expense, and interest expense increased less than one percent from 2015 expenses.

Key Ratios

The equity-to-total-assets ratio measures the percentage of total assets owned by members and is one of the indicators used to monitor the cooperative’s financial health. Homer Electric’s equity ratio was forty percent at year-end. This ratio at the end of 2015 was thirty-seven percent. The same ratio for Alaska Electric & Energy Cooperative (AEEC), Homer Electric’s subsidiary, which owns our generation and transmission assets, was fourteen percent in 2016 and twelve percent in 2015.

Total Assets and Total Liabilities

Total assets were $462 million in 2016. This is a two percent decrease from $472 million in 2015. Total liabilities were $367 million in 2016, a four percent decrease from $384 million the previous year.

Capital Credits

Capital credits represent Homer Electric members’ share of equity in the cooperative and are one of the benefits of being a member of an electric cooperative. Capital credits are based on margins, which are the difference between total expenses and total revenues of the cooperative. Each year, Homer Electric allocates margins to its members in proportion to the amount they paid for electric service during the year. Increased equity in 2016 allows HEA to resume the capital credit retirement program. In April of 2017, approximately 10,000 current and former members received $1.5 million in capital credit checks. In 2016, the Board of Directors also approved almost $300,000 for the retirement of capital credits to estates of deceased members.

Financial Goals

In conclusion, Homer Electric met its financial goals with positive margins and met required loan agreement ratios in 2016. Homer Electric’s financial management and resulting financial performance allows the Cooperative to continue to meet the energy needs of our members through innovative energy solutions, while ensuring fair and reasonable rates.
### Homer Electric Association, Inc. and Subsidiary
#### Consolidated Statements of Operations and Patronage Capital

<table>
<thead>
<tr>
<th>Years Ended December 31,</th>
<th>2016</th>
<th>2015</th>
</tr>
</thead>
<tbody>
<tr>
<td>Operating Revenues</td>
<td>$96,784,876</td>
<td>$97,161,653</td>
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<tr>
<td>Operating Expenses</td>
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<tr>
<td>Fuel costs</td>
<td>30,514,757</td>
<td>31,868,516</td>
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<td>Production operations and maintenance</td>
<td>6,820,313</td>
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<td>Purchased power costs</td>
<td>3,219,705</td>
<td>4,208,038</td>
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<td>Transmission operations and maintenance</td>
<td>966,038</td>
<td>1,033,794</td>
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<td>Distribution operations and maintenance</td>
<td>6,022,279</td>
<td>5,624,963</td>
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<tr>
<td>Consumer accounts, service and sales</td>
<td>3,732,936</td>
<td>3,970,572</td>
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<td>Administrative, general and other</td>
<td>8,664,179</td>
<td>8,199,173</td>
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<td>Depreciation and amortization</td>
<td>17,274,406</td>
<td>16,592,106</td>
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<tr>
<td>Total Operating Expenses</td>
<td>77,214,613</td>
<td>78,662,221</td>
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<tr>
<td>Interest Expense</td>
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<td></td>
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<tr>
<td>Long-term debt and other</td>
<td>13,936,297</td>
<td>14,439,745</td>
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<tr>
<td>Allowance for funds used during construction</td>
<td>(153,627)</td>
<td>(217,753)</td>
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<tr>
<td>Net Interest Expense</td>
<td>13,782,670</td>
<td>14,221,992</td>
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<td>Net operating margins</td>
<td>5,787,593</td>
<td>4,277,440</td>
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<tr>
<td>Nonoperating Margins</td>
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<tr>
<td>Interest income</td>
<td>155,838</td>
<td>161,041</td>
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<tr>
<td>Gain on sale of assets</td>
<td>-</td>
<td>96,537</td>
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<tr>
<td>Other income (expense)</td>
<td>(8,278)</td>
<td>(5,828)</td>
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<td>Capital credits, patronage dividends and other</td>
<td>849,695</td>
<td>1,179,517</td>
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<tr>
<td>Total Nonoperating Margins</td>
<td>997,255</td>
<td>1,431,267</td>
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<tr>
<td>Net margins</td>
<td>6,784,848</td>
<td>5,708,707</td>
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<td>Patronage capital, beginning of year</td>
<td>85,100,128</td>
<td>79,518,903</td>
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<tr>
<td>Less retirement of patronage capital credits</td>
<td>(292,702)</td>
<td>(127,482)</td>
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<tr>
<td>Patronage Capital, end of year</td>
<td>$91,592,274</td>
<td>$85,100,128</td>
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