Homer Electric Association, Inc. and Subsidiary
(Alaska 5 and Alaska 33 Kenai)

Consolidated Financial Statements and Supplementary Information
Years Ended December 31, 2016 and 2015

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Independent Auditor's Report

Board of Directors
Homer Electric Association, Inc. and Subsidiary
Homer, Alaska

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of Homer Electric Association, Inc. and Subsidiary (the "Association"), which comprise the consolidated balance sheets as of December 31, 2016 and 2015, and the related consolidated statements of operations and patronage capital, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Homer Electric Association, Inc. and its Subsidiary as of December 31, 2016 and 2015, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Supplementary Information
Our audit was conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The consolidating balance sheets and consolidating statements of operations and patronage capital are presented for purposes of additional analysis and are not a required part of the basic consolidated financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated, in all material respects, in relation to the consolidated financial statements as a whole.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated March 31, 2017 on our consideration of Homer Electric Association, Inc and Subsidiary's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering Example Entity's internal control over financial reporting and compliance.

BDO USA, LLP

Anchorage, Alaska
March 31, 2017

Consolidated Financial Statements

Homer Electric Association, Inc. and Subsidiary

Consolidated Balance Sheets

December 31,	2016	2015
Assets		
Utility plant, at cost:		
Electric plant in service	$ 579,216,752	$ 571,497,008
Electric plant held for future use	1,166,067	1,166,067
Construction work in progress	10,943,553	11,882,107
Total utility plant, at cost	591,326,372	584,545,182
Less accumulated depreciation and amortization	(184,967,399)	(170,380,130)
Net utility plant	406,358,973	414,165,052
Other assets and investments:		
Investments in associated organizations	24,082,128	23,730,008
Notes receivable, net of current portion	402,935	525,846
Non-utility property, net of accumulated depreciation of $513,635 ($477,939 in 2015)	447,691	267,173
Total other assets and investments	24,932,754	24,523,027
Current Assets		
Cash and cash equivalents	4,045,468	6,670,692
Accounts receivable, less allowance for doubtful accounts of $150,820 ($134,104 in 2015)	7,688,365	7,319,963
Unbilled revenue	6,275,502	6,040,812
Materials, fuel and supplies inventory	6,472,060	6,458,418
Notes receivable, current portion	296,107	282,917
Other current and accrued assets	330,895	421,093
Total Current Assets	25,108,397	27,193,895
Deferred charges	5,402,853	5,826,670
Total Assets	$ 461,802,977	$ 471,708,644

See accompanying notes to consolidated financial statements.

Homer Electric Association, Inc. and Subsidiary

Consolidated Balance Sheets, continued

December 31,	2016	2015
Equities and Liabilities		
Equities		
Memberships	$ 50,805	$ 53,320
Patronage capital	91,592,274	85,100,128
Other equities - donated capital	2,791,565	2,782,315
Total Equities	94,434,644	87,935,763
Liabilities		
Long-term Debt - mortgage notes payable	340,701,253	353,729,944
Current Liabilities		
Current portion of long-term debt	16,907,602	17,672,815
Accounts payable	3,733,947	6,568,469
Consumer deposits	1,215,453	1,225,895
Accrued payroll and benefits	2,603,186	2,534,928
Accrued taxes and other current liabilities	1,329,892	1,348,122
Total Current Liabilities	25,790,080	29,350,229
Deferred Credits	877,000	692,708
Total Equities and Liabilities	$ 461,802,977	$ 471,708,644

See accompanying notes to consolidated financial statements.

Homer Electric Association, Inc. and Subsidiary

Consolidated Statements of Operations and Patronage Capital

Years Ended December 31,	2016	2015
Operating Revenues	$ 96,784,876	$ 97,161,653
Operating Expenses		
Fuel costs	30,514,757	31,868,516
Production operations and maintenance	6,820,313	7,165,059
Purchased power costs	3,219,705	4,208,038
Transmission operations and maintenance	966,038	1,033,794
Distribution operations and maintenance	6,022,279	5,624,963
Consumer accounts, service and sales	3,732,936	3,970,572
Administrative, general and other	8,664,179	8,199,173
Depreciation and amortization	17,274,406	16,592,106
Total Operating Expenses	77,214,613	78,662,221
Interest Expense		
Long-term debt and other	13,936,297	14,439,745
Allowance for funds used during construction	(153,627)	(217,753)
Net Interest Expense	13,782,670	14,221,992
Net operating margins	5,787,593	4,277,440
Nonoperating Margins		
Interest income	155,838	161,041
Gain on sale of assets	-	96,537
Other income (expense)	(8,278)	(5,828)
Capital credits, patronage dividends and other	849,695	1,179,517
Total Nonoperating Margins	997,255	1,431,267
Net margins	6,784,848	5,708,707
Patronage capital, beginning of year	85,100,128	79,518,903
Less retirement of patronage capital credits	(292,702)	(127,482)
Patronage Capital, end of year	$ 91,592,274	$ 85,100,128

See accompanying notes to consolidated financial statements.

Homer Electric Association, Inc. and Subsidiary

Consolidated Statements of Cash Flows

Years Ended December 31,	2016	2015
Cash Flows from Operating Activities		
Cash received from customers	$ 95,780,655	$ 97,911,047
Cash paid to suppliers and employees	(62,080,233)	(62,285,281)
Interest and dividends received	155,838	161,041
Interest paid	(13,936,297)	(14,439,745)
Taxes paid	(245,604)	(218,251)
Other	(8,278)	90,709
Net cash from operating activities	19,666,081	21,219,520
Cash Flows for Investing Activities		
Plant additions	(12,992,163)	(17,178,700)
Contributions in aid of construction, including grant reimbursements	3,493,314	3,597,984
Salvage on plant retirements	5,079	(163,214)
Cost of removal	(310,133)	(542,251)
Patronage refunds from associated organizations	704,250	752,082
Investments in associated organizations	(206,656)	(607,010)
Changes in assets and liabilities that provided (used) cash:		
Accounts payable, construction	-	(57,444)
Materials, fuel and supplies inventories	(13,642)	(564,371)
Deferred charges	934,667	(1,468,991)
Deferred credits	184,292	147,857
Net cash for investing activities	(8,200,992)	(16,084,058)
Cash Flows for Financing Activities		
Proceeds from long-term debt	3,500,000	8,000,000
Principal payments on long-term debt	(17,293,904)	(17,207,913)
Retirement of capital credits	(283,452)	(78,225)
Changes in assets and liabilities that provided (used) cash:		
Consumer deposits	(10,442)	32,454
Memberships	(2,515)	(2,515)
Net cash for financing activities	(14,090,313)	(9,256,199)
Net decrease in cash and cash equivalents	(2,625,224)	(4,120,737)
Cash and Cash Equivalents, beginning of year	6,670,692	10,791,429
Cash and Cash Equivalents, end of year	$ 4,045,468	$ 6,670,692

See accompanying notes to consolidated financial statements.

Homer Electric Association, Inc. and Subsidiary

Consolidated Statements of Cash Flows, continued

Years Ended December 31,	2016	2015
Reconciliation of Net Margins to Net Cash From Operating Activities		
Net margins	$ 6,784,848	$ 5,708,707
Adjustments to reconcile net margins to net cash from operating activities:		
Depreciation and amortization	17,583,091	17,481,446
Allowance for funds used during construction	(153,627)	(217,753)
Patronage capital from associated organizations (non-cash)	(849,714)	(1,215,031)
(Increase) decrease in assets:		
Accounts receivable, net	(368,402)	316,324
Notes receivable	109,721	116,007
Unbilled revenue	(234,690)	(264,667)
Cost of power adjustment (COPA)	(510,850)	581,730
Other current assets	90,198	27,524
Increase (decrease) in liabilities:		
Accounts payable, trade	(2,834,522)	(1,178,165)
Accrued payroll and benefits	68,258	(152,079)
Accrued taxes and other current liabilities	(18,230)	15,477
Total adjustments	12,881,233	15,510,813
Net Cash From Operating Activities	$ 19,666,081	$ 21,219,520

See accompanying notes to consolidated financial statements.

1. Summary of Significant Accounting Policies

Homer Electric Association, Inc. (HEA) is an electric utility engaged in the generation, transmission and distribution of electricity for its members. HEA was formed in 1945 as Alaska's fifth rural electric cooperative. Today it serves nearly 23,000 members over the 3,166 square-mile service territory on the southern Kenai Peninsula, including several remote communities across Kachemak Bay. Generation facilities consist of an 80-megawatt combined cycle facility in Nikiski, a 48-megawatt aero derivative simple cycle unit at Soldotna and three gas turbines at Bernice Lake facility capable of 80 megawatts. HEA operates on a not-for-profit basis and is recognized by the IRS as a 501(c)12 organization. Accordingly, it seeks only to generate revenues sufficient to pay operating and maintenance costs, the cost of purchased power, capital expenditures, depreciation, debt service, and to provide for reserves.

The accounting records of Homer Electric Association, Inc. conform to the Uniform System of Accounts prescribed by the Federal Energy Regulatory Commission as modified for electric borrowers of the Rural Utilities Service (RUS). HEA's accounting policies conform to generally accepted accounting principles as applied to the Financial Accounting Standards Board's (FASB) Accounting Standards Codification (ASC) 980 relating to accounting for regulated entities. A description of HEA's principle accounting policies follows:

Principles of Consolidation

The consolidated financial statements include a 100% owned subsidiary, Alaska Electric and Energy Cooperative, Inc. (AEEC). AEEC is a single-member cooperative with sales exclusively to HEA and provides all power requirements to HEA. All significant inter-company balances and transactions have been eliminated in consolidation.

Plant Additions and Retirements

Additions and replacements of electric plant in service are at original cost of contracted services, direct labor and materials, and indirect overhead charges. Except for certain specifically identifiable units of equipment, replacements and retirements of plant are charged to the accumulated provision for depreciation at the average unit cost of the property unit plus removal cost less salvage. The cost of replacement is added to electric plant.

Amortization

Deferred charges are amortized on a straight-line basis over periods ranging from 12 months to 180 months.

Materials and Supplies

Materials and supplies are primarily held for HEA's use in construction and maintenance projects and are stated at a moving weighted-average cost.

Revenues

Revenues are based on cycle billings rendered to customers monthly as well as the estimated amount accrued for services rendered but not billed at the end of the year.

Contributions in Aid of Construction

Contributions in aid of construction are credited to the associated cost of the property unit constructed.

Allowance for Funds Used During Construction

HEA capitalizes, as an additional cost of property, an allowance for funds used during construction that represents the allowed cost of borrowings and equity used to finance a portion of construction work in progress. The allowance for funds used during construction is recorded as revenue and allocated to special projects over $10,000.

Income Taxes

HEA and AEEC are exempt from federal income taxes under provisions of Section 501(c)(12) of the Internal Revenue Code.

HEA applies the provisions of Topic 740 of the Financial Accounting Standards Board (FASB) Accounting Standards Codification relating to accounting for uncertainty in income taxes. HEA annually reviews its tax positions taken in accordance with the recognition standards. It is HEA management's opinion that it has no uncertain tax positions which would require disclosure or adjustment in these financial statements.

Cost of Power Adjustment

Effective April 1, 1988, HEA adopted, with regulatory approval, a wholesale cost of power adjustment clause which provides for current collection of estimated amounts of purchased power costs with a subsequent settlement of amounts collected.

Based on the 2010 rate study which, after regulatory approval, became effective January 1, 2012, the Wholesale Power Cost Rate Adjustment (WPCRA) was changed to separate all fuel and purchased energy costs into a new single-item cost element on customer bills called a Cost of Power Adjustment (COPA). This rate includes the cost of fuel, purchased power from other sources, and Bradley Lake purchased power.

Statement of Cash Flows

For purposes of the statements of cash flows, HEA considers all cash and short-term investments that are readily convertible to known amounts of cash and that present an insignificant risk of change in value due to changes in interest rates or other factors to be cash equivalents.

Reclassification

Certain amounts included in the comparative financial statements have been reclassified to achieve comparability.

Credit Risk

Financial instruments which potentially subject HEA to concentrations of credit risk consist principally of temporary cash investments. HEA places its temporary cash investments with high credit quality financial institutions. Concentrations of credit risk with respect to trade receivables are limited to HEA's large number of customers.

Accounting Estimates

The presentation of the consolidated financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Fair Value of Financial Instruments

HEA measures certain items in these financial statements at fair value. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date, that is, other than in a forced liquidation or distress sale.

HEA's financial assets and liabilities carried at fair value have been classified based on a hierarchy as defined in generally accepted accounting principles and are generally measured using the market approach or the income approach.

Subsequent Events

HEA has evaluated subsequent events and transactions for potential recognition or disclosure through March 31, 2017, the date on which the financial statements were available to be issued. See Note 18.

2. Utility Plant and Depreciation Rates and Procedures

Major classes of HEA's utility plant at December 31, 2016 and 2015 are as follows:

	2016	2015
Production plant	$ 245,150,424	$ 244,481,188
Distribution plant	225,869,785	220,706,712
Transmission plant	67,825,214	67,825,214
General plant	31,703,631	31,186,608
Plant in service, unclassified	6,907,271	5,536,859
Plant leased to others	1,760,427	1,760,427
Total electric plant in service	579,216,752	571,497,008
Electric plant held for future use	1,166,067	1,166,067
Construction work in progress	10,943,553	11,882,107
Total Utility Plant, at Cost	$ 591,326,372	$ 584,545,182

Current leased plant consists of fiber optic lines. Depreciation of plant leased to others is reflected as a reduction of operating revenues in the consolidated statements of operations and patronage capital.

The Bernice Lake Power Plant purchased from Chugach Electric Association on December 31, 2012, included an acquisition adjustment of approximately $7.4 million. HEA received regulatory approval to recover the amortization of the acquisition adjustment through rates over a period of 15 years. The asset is recorded as part of production plant.

Electric plant held for future use reflects vacant land owned by HEA.

Construction work in progress at December 31, 2016, includes approximately $9.5 million for distribution construction projects and $1.4 million in generation and transmission projects.

Depreciation

HEA completed a Depreciation Study of utility plant that was approved by the Regulatory Commission of Alaska (RCA) with an effective date of January 1, 2016. The annual depreciation accrual rates were developed using the straight line method, vintage group procedure and remaining life technique. Depreciation accrual rates used in 2015 and 2016 vary by specific asset type according to these ranges:

	Range		
Production plant	1.00%	to	8.95%
Distribution plant	1.69%	to	6.51%
Transmission plant	0.71%	to	5.31%
General plant	0.18%	to	66.70%
Plant leased to others	5.00%	to	5.00%
Vehicles and equipment	15.00%	to	19.36%

Overhauls and hot gas path inspections on generation plant are capitalized and depreciated over the projected life of the repairs (two to six years). Depreciation on vehicles and equipment is charged to transportation clearing accounts.

Total depreciation and amortization for the years ended December 31, 2016 and 2015 is summarized below:

	2016	2015
Depreciation and amortization expense	$ 17,274,406	$ 16,592,106
Depreciation on leased plant	88,092	88,092
Total Depreciation and Amortization	$ 17,362,498	$ 16,680,198
Depreciation Charged to Clearing Accounts	$ 496,352	$ 600,415

3. Investments in Associated Organizations

Investments in associated organizations at December 31, 2016 and 2015 consisted of the following:

	2016	2015
Capital term certificates of the National Rural Utilities Cooperative Finance Corporation	$ 2,378,308	$ 2,565,808
Capital term non-interest bearing certificates of the National Rural Utilities Cooperative Finance Corporation	2,415,568	2,584,691
Investment in Kenai Hydro LLC	3,406,697	3,200,041
Patronage capital credits issued by:		
Southeastern Data Cooperative	201,471	203,190
Chugach Electric Association	7,972,598	7,972,598
National Rural Utilities Cooperative Finance Corporation	5,035,396	4,713,704
National Rural Telecommunications Cooperative, Inc.	562,069	562,069
Other	68,542	66,391
Equity contribution to the Alaska Rural Electric Cooperative Association Reciprocal Insurance Exchange	40,702	40,702
Allocation of margins from Alaska Rural Electric Cooperative Association Reciprocal Insurance Exchange	2,000,777	1,820,814
Total Investments in Associated Organizations	$ 24,082,128	$ 23,730,008

4. Cash and Cash Equivalents

HEA maintains its cash with Wells Fargo Bank, N.A. Accounts at this institution are insured by the Federal Deposit Insurance Corporation (FDIC) up to $250,000. Deposits held in noninterest-bearing transaction accounts are now aggregated with any interest-bearing deposits in the same ownership category, and the combined total is insured up to the $250,000 limit. At December 31, 2016 and 2015, the uninsured cash balance with Wells Fargo was $3,687,665 and $6,515,039, respectively.

HEA also makes temporary cash investments with National Rural Utilities Cooperative Finance Corporation (NRUCFC) throughout the year. At December 31, 2016 and 2015, there were no short-term cash investments.

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5. Accounts Receivable

Accounts receivable at December 31, 2016 and 2015 consisted of the following:

	2016	2015
Consumer accounts (energy bills)	$ 7,094,709	$ 6,704,041
Contract services	445,938	388,651
Grants receivable	37,611	327,108
Other	260,927	34,267
Total accounts receivable	7,839,185	7,454,067
Allowance for doubtful accounts	(150,820)	(134,104)
Total Accounts Receivable, net	$ 7,688,365	$ 7,319,963

6. Deferred Charges

At December 31, 2016 and 2015, deferred charges consisted of the following:

	2016	2015
Unused steam rights, to be amortized over 15 years	$ 3,119,992	$ 3,466,660
Wildfire damage costs, pending reimbursement	-	167,469
Facilities and projects in progress	14,134	58,419
Deferred charges (credits) on cost of power adjustment	(254,584)	(765,434)
HEA rate case	1,054,964	201,679
Costs of pending contract, tariff and rate cases	1,468,347	2,697,877
Total Deferred Charges	$ 5,402,853	$ 5,826,670

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7. Equities

At December 31, 2016 and 2015, equities consisted of the following:

	2016	2015
Memberships	$ 50,805	$ 53,320
Patronage capital:		
Assignable	6,784,848	5,708,707
Assigned	85,100,128	79,518,903
Total patronage capital	91,884,976	85,227,610
Less capital credits retired:		
Estates of deceased	(149,994)	(59,070)
Discounted portion	(142,357)	(67,717)
Applied to customer accounts	(351)	(695
Total capital credits retired	(292,702)	(127,482)
Net patronage capital	91,592,274	85,100,128
Other equities – donated capital at beginning of year	2,782,315	2,733,058
Net transfers from patronage capital for unlocated customers and other adjustments	9,250	49,257
Other equities – donated capital at end of year	2,791,565	2,782,315
Total Equities	$ 94,434,644	$ 87,935,763

Patronage capital credits are paid to the estates of deceased members and applied to customer accounts in accordance with the by-law requirements. See Note 18 for retirement of capital credits subsequent to year end.

Provisions in the long-term debt agreements with NRUCFC allow return of patrons' capital if after the distribution, equity of HEA will be at least twenty percent (20%) of its total assets. If, after giving effect to the distribution, total equity of HEA will be less than twenty percent (20%) of its total assets, then HEA may nevertheless make distributions up to thirty percent (30%) of its patronage capital or operating margins for the preceding calendar year.

8. Long-term Debt

Long-term debt consists of notes payable to National Rural Utilities Cooperative Finance Corporation (NRUCFC), National Cooperative Services Corporation (NCSC), Farmer Mac (FMAC) and Rural Utilities Service (RUS). The interest rates may be fixed or variable under conversion options provided in the loan agreements. The loans are collateralized by all of HEA's and AEEC's assets except for vehicles. The loans require HEA to maintain an average modified debt service coverage ratio of not less than 1.35. AEEC's loans require an average modified debt service coverage ratio of not less than 1.05, a minimum equity ratio of 12% through 2017, and 15% minimum ratio from 2018 through maturity. The RUS loan requires a 1.05 minimum TIER. HEA and AEEC were in compliance with these debt covenants.

Mortgage notes payable at December 31, 2016 and 2015 were as follows:

	2016	2015
NRUCFC:		
HEA mortgage notes payable at varying interest rates from 2.85% to 5.75%; principal and interest due quarterly until maturity in 2040.	$ 41,593,511	$ 42,971,033
HEA mortgage notes payable at varying interest rates from 3.2% to 7.15%; principal and interest due quarterly until maturity in 2046.	61,797,215	64,084,824
AEEC mortgage notes payable at varying interest rates from 2.50% to 6.65%; principal and interest due quarterly until maturity in 2046.	36,712,401	35,705,108
AEEC mortgage notes payable at interest rate of 3.15%; interest due quarterly; principal due annually until maturity in 2017.	2,000,000	5,000,000
AEEC mortgage notes payable at interest rate of 6.15%; principal and interest due quarterly until maturity in 2043.	14,585,131	14,798,894
Total NRUCFC	156,688,259	162,559,859
NCSC:		
AEEC mortgage notes payable at varying interest rates from 3.50% to 4.70%; principal and interest due quarterly until maturity in 2044.	38,150,996	39,451,818

	2016	2015
RUS:		
AEEC mortgage notes payable at varying interest rates from 2.910% to 3.188%; principal and interest due quarterly until maturity in 2040.	$ 135,849,057	$ 141,509,434
Advance payments unapplied; in RUS Cushion of Credit	(268,428)	(255,594)
Total RUS	135,580,629	$ 141,253,840
FMAC:		
HEA mortgage notes payable at varying interest rates from 1.717% to 4.960%; principal and interest due semi-annually until maturity in 2042.	27,188,972	28,137,242
Total long-term debt	357,608,855	371,402,759
Less current portion	(16,907,602)	(17,672,815)
Total Long-term Debt, Excluding Current Portion	$ 340,701,253	$ 353,729,944

Receipt of NRUCFC loans requires commitments to purchase non-interest bearing capital term certificates. Balances of these NRUCFC certificates were $2,415,568 and $2,584,691 for 2016 and 2015, respectively (See Note 3).

The annual requirements for reduction of long-term debt outstanding as of December 31, 2016, are estimated to be as follows:

Year Ending December 31,	
2017	$ 16,907,602
2018	14,643,925
2019	14,774,510
2020	14,528,618
2021	14,427,270
Thereafter	282,326,930
	$ 357,608,855

At December 31, 2016, HEA and AEEC had long-term unadvanced loan facilities available from NRUCFC of $19,000,000 and $23,000,000, respectively. At December 31, 2015, HEA and AEEC had long-term unadvanced loan facilities available from NRUCFC of $20,500,000 and $25,000,000, respectively.

9. Lines of Credit

HEA and AEEC each established a revolving line of credit loan with NRUCFC in amounts not to exceed $5,000,000 and $10,000,000, respectively. Advances are subject to CFC approval and variable rate interest payments are due quarterly. The line of credit for HEA is perpetual and the maturity date for AEEC in 2019. There were no outstanding balances at December 31, 2016 and 2015 on the lines of credit. In January 2017, HEA and AEEC each drew $2,000,000 on their respective lines of credit with NRUCFC.

10. Deferred Credits

At December 31, 2016 and 2015, deferred credits consisted of the following:

	2016	2015
Consumer prepayments	$ 22,036	$ 43,549
Standard labor on transformers and meters	854,964	649,159
Total Deferred Credits	**$ 877,000**	**$ 692,708**

11. Employee Benefits

Defined Benefit Pension Plans

Pension benefits for substantially all employees are provided through participation in the National Rural Electric Cooperative Association (NRECA) and Alaska Electrical Trust Fund retirement programs. Both plans are master multi-employer defined benefit plans qualified under Section 401 and tax-exempt under Section 501(a) of the Internal Revenue Code. A unique characteristic of a multi-employer plan compared to a single employer plan is that all plan assets are available to pay benefits of any plan participant. Separate asset accounts are not maintained for participating employers. This means that assets contributed by one employer may be used to provide benefits to employees of other participating employers.

NRECA Retirement Security Plan Information

The National Rural Electric Cooperative Association (NRECA) Retirement Security Plan (RS Plan) is considered a multi-employer plan under the accounting standards. The plan sponsor's Employer Identification Number is 53-0116145 and the Plan Number is 333. HEA contributions to the RS Plan in 2016 and 2015 represented less than five percent of the total contributions made to the RS Plan by all participating employers. HEA contributed to the RS Plan $2,493,210 in 2016 and $2,642,665 in 2015. There have been no significant changes that affect the comparability of 2016 and 2015 contributions.

For the RS Plan, a "zone status" determination is not required, and therefore not determined, under the Pension Protection Act (PPA) of 2006. In addition, the accumulated benefit obligations and plan assets are not determined or allocated separately by individual employer. In total, the RS Plan was over 80 percent funded on January 1, 2016 and 2015 based on the PPA funding target and PPA actuarial value of assets on those dates.

Because the provisions of the PPA do not apply to the RS Plan, funding improvement plans and surcharges are not applicable. Future contribution requirements are determined each year as part of the actuarial valuation of the RS Plan and may change as a result of plan experience.

Alaska Electrical Pension Plan Information

The Alaska Electrical Pension Plan sponsor's Employer Identification Number is 92-6005171 and the Plan Number is 001. HEA contributions to the Plan in 2016 and in 2015 represented less than five percent of the total contributions made to the Plan by all participating employers. HEA contributed to the Plan $1,471,877 in 2016 and $1,446,002 in 2015. There have been no significant changes that affect the comparability of 2016 and 2015 contributions. In total, the Alaska Electrical Pension Plan was certified by the Plan actuary with a green zone status at December 31, 2016 and 2015. The Plan is not subject to funding improvement plans or rehabilitation plans and as a result, HEA is not subject to contribution surcharges. There are no minimum funding commitments as negotiated contributions currently satisfy HEA's commitment towards meeting the annual minimum funding requirement for the Alaska Electrical Pension Plan. Future contribution requirements are determined each year as part of the actuarial valuation of the Plan and may change as a result of plan experience.

The expiration dates for HEA's collective bargaining agreements range from April 30, 2018 to April 30, 2021.

401(k) Plan

Effective January 1, 1988, HEA adopted a 401(k) plan covering substantially all employees who elect to participate. Employees are allowed to contribute up to the maximum dollar amounts permitted by the IRS each year. HEA contributes 1.0% of the straight time compensation for nonunion employees and an additional 2.0% on a matching basis. HEA contributes 6.0% of the straight time compensation on inside union employees. The employer contribution made for generation unit and outside union employees was $1.75 per hour. The total contributions to the Plan for the years ended December 31, 2016 and 2015 were $507,860 and $587,294, respectively.

12. Deferred Compensation Plan

HEA participates in the deferred compensation plan offered to similar cooperatives by NRECA. This program provides a deferral of current earnings by select or qualifying employees to a future period and is entirely funded by the employee.

13. Purchased Power

In 2014, AEEC began generating and supplying wholesale electric power for HEA. The all-requirements contract between HEA and AEEC shall remain in effect until December 31, 2050 and thereafter until terminated by either party. The amount charged by AEEC to HEA for wholesale power covers all fixed and variable costs for operation of the generation and transmission assets. Additionally, the amount charged must provide an average minimum modified debt service coverage ratio of 1.05 as defined in the NRUCFC mortgage and a minimum 1.05 TIER as defined by RUS.

14. Bradley Lake Hydroelectric Project

The Bradley Lake Hydroelectric Project Power Sales Agreement between the owner, the Alaska Energy Authority, and the utility participants was approved by RUS on June 29, 1989. In exchange for HEA's payment of its proportionate share of the debt service on the project bonds and actual operation and maintenance costs, HEA is entitled to a 12% share or between 10.8 and 13.8 megawatts (MW) and 12% of the plant's energy production, of which HEA's share currently averages 45,600 megawatt hours annually. As of 2014, HEA schedules its own Bradley Lake Power through the project dispatcher, Chugach Electric Association. Effective June 30, 2003 HEA has assigned its share of Bradley Lake power to AEEC pursuant to its requirements contract with AEEC.

AEEC paid $2,068,987 and $2,150,169 for Bradley Lake power during 2016 and 2015, respectively. Minimum future payments, which started January 1, 2000 and will continue until 2027, are approximately $1,400,000 per year.

15. Regulatory Matters

HEA was granted approval by the Regulatory Commission of Alaska (RCA) to use the Simplified Rate Filing Procedures for Electric Cooperatives on June 10, 1991. In 2015, HEA received approval for an 8.00% base rate increase effective May 7, 2015.

On October 30, 2015, HEA filed a request with the RCA for approval of its general rate case filing for test year 2014. The filing also included a request for interim and refundable rates of 3.25%, which was granted effective February 1, 2016. New permanent rates were approved by the RCA and went into effect January 5, 2017.

On November 14, 2013, HEA filed a request with the RCA for approval of transmission and related ancillary service tariffs. As of December 31, 2016, this case is still pending final approval from the RCA; hence no associated revenues are recorded in 2016. This issue also has pending litigation in both the Superior and Supreme Courts.

16. Affiliated Organizations

Kenai Hydro, a limited liability company, was formed in 2008 for the purpose of evaluating, investigating and planning low impact hydroelectric facilities on the Kenai Peninsula. Grants from the State of Alaska awarded to Kenai Hydro LLC have been used to pursue a FERC license for hydroelectric facilities. In 2015 HEA transferred its membership in Kenai Hydro to AEEC. As a single-member LLC, Kenai Hydro is considered by the IRS as a disregarded entity for tax purposes.

17. Major Customer

Power sales to three commercial customers totaled $12,189,430 and $13,626,454, or 12.6% and 14.0% of total operating revenues in 2016 and 2015, respectively.

18. Subsequent Event – Capital Credits

In February 2017, the Board of Directors approved the retirement of $1.5 million in regular capital credits.

19. Contingencies and Commitments

HEA is subject to extensive federal, state and local environmental laws and regulations. These laws and regulations, which are constantly changing, regulate the discharge of materials into the environment and may require HEA to remove or mitigate the environmental effects of the disposals or release of substances at various sites. Environmental expenditures are expensed or capitalized depending on their future economic benefit. Expenditures that relate to an existing condition caused by past operations and that have no economic benefits are either expensed in the current period or amortized over an approved period of time. Liabilities for expenditures of a noncapital nature are recorded when environmental assessments and/or remediation is probable, and the costs can be reasonably estimated.

Although the level of future expenditures for environmental matters is impossible to determine, it is management's opinion that such costs when finally determined will not have a material effect on the financial position of HEA.

In the normal course of business, HEA is involved in various claims and litigation. In the opinion of management and HEA's legal counsel, the disposition of these matters is not expected to have a material adverse effect on HEA's financial statements.

20. Grant Revenues

HEA and AEEC received grant funding from various state agencies to assist with the costs of several different projects, including repair and construction of transmission lines and structures, re-clearing activities, the replacement of an emergency diesel generator, and replacement of facilities damaged by wildfires. In accordance with industry standards, HEA has chosen to account for grant revenues either as a reduction of expenses or as a reduction in the costs of capital improvements. Total grant reimbursable expenses incurred were $1,075,248 and $1,892,168 in 2016 and 2015, respectively.

Due to several wildfires on the Kenai Peninsula in 2015, HEA and AEEC submitted reimbursement requests for $286,830 in State Disaster Public Assistance Grants from the State of Alaska Division of Homeland Security and Emergency Management (DHSEM). In 2016, DHSEM reimbursed $32,841 and the balance of $253,989 is included in accounts receivable at December 31, 2016 and subsequently paid on February 10, 2017.

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Supplementary Information

Homer Electric Association, Inc. and Subsidiary

Consolidating Balance Sheet

December 31, 2016	Homer Electric Association	Alaska Electric and Energy Cooperative	Eliminations	Consolidated Totals
Assets				
Utility Plant at Cost:				
Electric plant in service	$ 261,600,115	$ 317,616,637	$ -	$ 579,216,752
Electric plant held for future use	1,166,067	-	-	1,166,067
Construction work in progress	9,538,105	1,405,448	-	10,943,553
Total utility plant, at cost	272,304,287	319,022,085	-	591,326,372
Less accumulated depreciation and amortization	(106,004,937)	(78,962,462)	-	(184,967,399)
Net Utility Plant	166,299,350	240,059,623	-	406,358,973
Other Assets and Investments:				
Investments in associated organizations	47,166,282	14,476,323	(37,560,477)	24,082,128
Notes receivable, net of current portion	402,935	-	-	402,935
Non-utility property, net of accumulated depreciation of $513,635	231,477	216,214	-	447,691
Total Other Assets and Investments	47,800,694	14,692,537	(37,560,477)	24,932,754
Current Assets				
Cash and cash equivalents	2,357,261	1,688,207	-	4,045,468
Accounts receivable, less allowance for doubtful accounts of $150,820	8,975,728	6,788,738	(8,076,101)	7,688,365
Unbilled revenue	6,275,502	-	-	6,275,502
Materials, fuel and supplies inventory	3,829,449	2,642,611	-	6,472,060
Notes receivable, current portion	296,107	-	-	296,107
Other current and accrued assets	327,765	3,130	-	330,895
Total Current Assets	22,061,812	11,122,686	(8,076,101)	25,108,397
Deferred Charges	2,152,077	3,250,776	-	5,402,853
Total Assets	$ 238,313,933	$ 269,125,622	$ (45,636,578)	$ 461,802,977

Homer Electric Association, Inc. and Subsidiary

Consolidating Balance Sheet, continued

December 31, 2016	Homer Electric Association	Alaska Electric and Energy Cooperative	Eliminations	Consolidated Totals
Equities and Liabilities				
Equities				
Memberships	$ 50,805	$ -	$ -	$ 50,805
Patronage capital	91,592,274	28,360,436	(28,360,436)	91,592,274
Other equities - donated capital	2,791,565	9,200,041	(9,200,041)	2,791,565
Total Equities	94,434,644	37,560,477	(37,560,477)	94,434,644
Liabilities				
Long-term Debt - mortgage notes payable	123,957,956	216,743,297	-	340,701,253
Current Liabilities				
Current portion of long-term debt	6,621,743	10,285,859	-	16,907,602
Accounts payable	7,274,059	4,535,989	(8,076,101)	3,733,947
Consumer deposits	1,215,453	-	-	1,215,453
Accrued payroll and benefits	2,603,186	-	-	2,603,186
Accrued taxes and other current liabilities	1,329,892	-	-	1,329,892
Total Current Liabilities	19,044,333	14,821,848	(8,076,101)	25,790,080
Deferred Credits	877,000	-	-	877,000
Total Equities and Liabilities	$ 238,313,933	$ 269,125,622	$ (45,636,578)	$ 461,802,977

Homer Electric Association, Inc. and Subsidiary

Consolidating Statement of Operations and Patronage Capital

Year Ended December 31, 2016	Homer Electric Association	Alaska Electric and Energy Cooperative	Eliminations	Consolidated Totals
Operating Revenues	$ 95,466,938	$ 63,108,584	$ (61,790,646)	$ 96,784,876
Operating Expenses				
Fuel costs	-	30,514,757	-	30,514,757
Production operations and maintenance	-	6,820,313	-	6,820,313
Purchased power costs	61,923,926	3,086,425	(61,790,646)	3,219,705
Transmission operations and maintenance	-	966,038	-	966,038
Distribution operations and maintenance	6,022,279	-	-	6,022,279
Consumer accounts, service and sales	3,732,936	-	-	3,732,936
Administrative, general and other	8,469,013	195,166	-	8,664,179
Depreciation and amortization	7,244,713	10,029,693	-	17,274,406
Total Operating Expenses	87,392,867	51,612,392	(61,790,646)	77,214,613
Interest Expense				
Long-term debt and other	5,424,075	8,512,222	-	13,936,297
Allowance for funds used during construction	(153,627)	-	-	(153,627)
Net Interest Expense	5,270,448	8,512,222	-	13,782,670
Net operating margins	2,803,623	2,983,970	-	5,787,593
Nonoperating Margins				
Interest income	121,303	34,535	-	155,838
Other expense	(4,450)	(3,828)	-	(8,278)
Capital credits, patronage dividends and other	3,864,372	242,073	(3,256,750)	849,695
Total Nonoperating Margins	3,981,225	272,780	(3,256,750)	997,255
Net margins	6,784,848	3,256,750	(3,256,750)	6,784,848
Patronage capital, beginning of year	85,100,128	25,103,686	(25,103,686)	85,100,128
Less retirement of patronage capital credits	(292,702)	-	-	(292,702)
Patronage Capital, end of year	$ 91,592,274	$ 28,360,436	$ (28,360,436)	$ 91,592,274