

CHARGED UP FOR THE FUTURE

2018 Annual Report



Homer Electric
Association, Inc.

A Touchstone Energy Cooperative

Your Member-Owned Cooperative

MESSAGE from the BOARD PRESIDENT & MANAGEMENT

You might think that operating a member-owned electric cooperative is a fairly routine task. In fact, there is no end of interesting challenges for your Homer Electric Association (HEA) Board of Directors and staff.

MAJOR CHALLENGES

Warmer Seasons

Climate change has certainly had a visible impact on your cooperative. The warmer winters have put downward pressure on energy sales while maintenance costs have risen. For example, during the summer of 2016, glacial flooding washed out a natural earthen dam resulting in an inrush of floodwaters in and around HEA's power line serving the Halibut Cove area. Last summer in 2018, the flood waters returned and compromised the electric facilities to the extent generators were barged in to serve the community of Halibut Cove, while contingency plans were implemented. For several years in a row, as a result of Alaska's warmer seasons, glacial flooding occurred in this area where it has not been a problem for more than 40 years. As warmer seasons continue, we are expecting additional impact to our system.

Dependence on Natural Gas

This winter, our primary (and lowest-cost) natural gas supplier suffered a plugged pipeline. Fortunately, HEA was able to secure natural gas from the only other large supplier in South Central Alaska. Even though there is reputed to be a lot of untapped natural gas in the Cook Inlet Basin, compared to the Lower 48, total demand for natural gas (and electricity) in Cook Inlet is small. Exploration and development is relatively expensive and risky. Partly as a consequence, the Cook Inlet area does not support many natural gas suppliers competing to sell natural gas to the utilities. Because of the limited supply, continued upward pressure on natural gas prices is one reason why HEA is analyzing several new sources of electric energy that are not dependent on natural gas.



Brad Janorschke
General Manager

STRATEGIC INITIATIVES

In the fall of 2017, the board and staff identified three strategic initiatives dealing with natural gas reliance, Railbelt electric transmission, and communication with our members. In 2018, we made significant progress on **Strategic Initiative No. 1**, which is to reduce HEA's

dependence on natural gas and diversify our sources of electric energy. One example is the Battle Creek expansion project that will put more water into Bradley Lake, increasing annual Bradley Lake energy production by 10 percent.

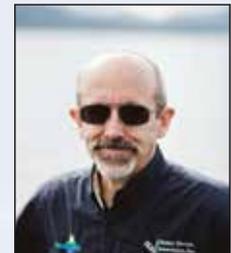
Last spring at the board's request, HEA solicited responses to a Request for Proposal sent to photovoltaic suppliers to construct a solar project on HEA property near Anchor Point. Initially, eight vendors expressed interest however, HEA received only two proposals. In a 4-4 vote, the board decided to reject the proposals, primarily due to cost considerations.

Following the decision to not proceed with the solar project as originally conceived, the board agreed to survey members' interest and willingness to financially commit to a community solar project. HEA would install and maintain the project and interested members could support by purchasing shares at approximately \$10 per share (100 kWh) per month. Supporters would benefit by having access to locally produced solar energy, while also providing support for the first utility scale solar project on the Peninsula. Unfortunately, only 69 HEA members committed to participate in the proposed project. As future costs decline and member interest increases, the board will reconsider visiting a solar project.

Our **Strategic Initiative No. 2** is to engage more effectively in ongoing discussions about restructuring Alaska's inter-connected Railbelt electrical grid. This has involved a collaborative effort among the electric utilities to analyze potential benefits from re-organizing the way wholesale power is delivered on the Railbelt. These complex discussions continue to advance in what can be described as a continuing kaleidoscope of shifting possibilities, opportunities, uncertainties, and risks.

In addition, these Railbelt-scale discussions have been complicated by Chugach Electric Association's anticipated acquisition of the City of Anchorage's electric utility, Municipal Light and Power. The acquisition introduces additional uncertainties in the electric wholesale power market.

Our **Strategic Initiative No. 3** is to improve communication with you, our members. You can help us with that effort by participating in our New Energy Technology workshop, monthly board meetings, annual



Dan Chay
Board President

meeting, fall community meetings, etc. In addition, we continue to focus on safety education in the schools and area events. We welcome feedback about how that is going and how we can continue to improve.

LOOKING AHEAD

In the years ahead, your board looks forward to increased adoption of electric vehicles, which eventually may help HEA offset declining loads, maintain optimal generation efficiency, and reduce our contribution to greenhouse gases. Your management actively has been exploring models to support electric vehicle charging.

In addition, the HEA Board remains acutely sensitive to the cost of electricity for you, our members. We consistently seek ways to minimize costs without sacrificing the system maintenance required to keep the electric grid safe and efficient. Your participation in the cooperative is appreciated and will help us provide better service to you.

Sincerely,

*HEA Board President Dan Chay
General Manager Brad Janorschke*



CHARGED UP for the FUTURE

Our future is ever-changing, always charging on. In our daily lives, from the computers and phones we plug in, to appliances to make our life convenient, and perhaps, the cars we may drive soon – we rely on electricity

every single day. Homer Electric Association, Inc. (HEA) is always seeking to efficiently maintain, improve, and explore innovative means to bring our members affordable and reliable power.

2018 YEAR in REVIEW

Powered Up

HEA continued its momentum on several projects to reduce our overall dependence on natural gas, explore renewable energy, and maximize efficiency of our existing infrastructure. These long-term plans will provide stability for your cooperative.

Battle Creek Project

In an effort to increase the annual output of the state-owned Bradley Lake Hydroelectric Plant, the Battle Creek Project started its first season of construction in 2018. This project would divert runoff from the Battle Creek Glacier into Bradley Lake. The \$48 million project will enable the facility, which currently produces the lowest cost power between Homer and Fairbanks, to increase its annual output by about 10% for the next 80 years. Battle Creek



Battle Creek Project

should provide between 28,000 MWh and 48,000 MWh depending on the amount of rainfall received in a year. In 2018, work began on the new 2.9 mile road to facilitate upcoming construction in 2019. Railbelt utilities, including HEA, will secure state funding for the project and is expected to take two to three years to complete.

Grant Lake Hydroelectric Project Update

In October 2018, the Grant Lake Hydroelectric Project reached another major milestone when the Federal Energy Regulatory Commission (FERC) issued the Draft Environmental Impact Statement (DEIS). In November 2018, FERC held a series of meetings in Moose Pass and a FERC licensing decision will be announced in the second quarter of 2019.

Garbage to Gas

HEA, in partnership with the Kenai Peninsula Borough (KPB), is investigating the feasibility of a Landfill Gas Project. The proposed project would capture the methane gas produced from landfill garbage and convert it to electricity in an internal combustion engine generator. The waste heat from the combustion engine would then be used to run the landfill leachate evaporator. HEA and KPB are splitting the cost of the feasibility study, which includes a preliminary design and economic analysis.



MEMBERCHOICE Community Solar Project

In 2018, HEA launched an initiative, the MEMBERCHOICE Community Solar Project, in response to members' growing interest and requests for more renewable energy opportunities. While renewables is a good idea, the cost of generating renewable solar energy in Alaska is higher than the energy produced by HEA's other current generation facilities. Therefore, HEA explored the feasibility of a program where members could purchase one or more units of 100 kilowatt hours of solar energy from a community solar farm. The idea was debuted at the Annual Meeting of the Members in May 2018 and implementation was dependent on a sufficient number of interested members. The program was advertised in the local newspapers, member newsletter, fall area meetings, and on the HEA website. HEA members were offered the chance to submit their interest and intent to commit to the program. Despite the low member subscription to the program halting the continuation of the program, HEA continues to keep solar energy opportunities on its radar.



PROTECTING The Cooperative's Interests

Protecting HEA's interests at the Regulatory Commission of Alaska (RCA) is an important component in controlling costs associated with the transportation and storage of natural gas used to generate HEA's power. In 2018:

- HEA supported rate reductions for ENSTAR and Cook Inlet Natural Gas Storage Alaska (CINGSA) associated with the tax cuts authorized in the 2017 Tax Cut and Jobs Act.
- HEA achieved an annual savings of \$39,330 in the rates Members pay for CINGSA by participating in Dockets U-18-004 and U-18-005.
- Work continues at the RCA with our active participation in the CINGSA rate case which is currently on-going.

CHARGED UP FOR INNOVATION

HEA Assesses Electric Vehicle

The appeal of electric vehicles is gaining momentum around the country. The push for greater mileage in terms of miles per gallon has been joined by the push for greater miles per charge. With that spirit of efficiency, HEA debuted the cooperative's first electric car, a Chevrolet Bolt, at the 2018 Annual Meeting to be used in its rotation of pool vehicles. The experience will give valuable insight to the real world driving of an electric car and how it performs in Alaska. Currently, there is only one public charging point on the Kenai Peninsula at Whistle Hill in Soldotna. HEA has a charging station specific to the Bolt at both HEA offices. With approximately 500 electric vehicles in Alaska, the goal is to work with other establishments to secure more public charging stations on the Kenai Peninsula.



TAKING CHARGE: System Upgrades & Maintenance

While our commitment to innovation is steadfast, our commitment to safely providing reliable electricity to our members and community is our main daily priority.

In 2018, HEA accomplished the following projects with that priority in mind.

TRANSMISSION PROJECTS

- 115kV Transmission Line Reclearing – HEA continued the vegetation removal work on our 300 miles of high voltage transmission lines to keep trees away from them to minimize the possibility of fires.
- 115kV Line Maintenance Outage – Scheduled power line maintenance was conducted on the 115kV line between Sterling and Cooper Landing.

DISTRIBUTION PROJECTS

- Degraded Power Pole Replacements – Replaced approximately 15 degraded power poles discovered as a result of HEA's routine pole testing program.
- Kenai Spur Highway Power Line Realignment – In accordance with Alaska Department of Transportation's multi-phase project to reconstruct and widen the Kenai Spur Highway between Kenai and Soldotna, HEA crews moved and realigned its power lines within that area. In addition, the overhead fiber optics were replaced.
- Homer Spit Switch Cabinet Replacement – In 2018, three switch cabinets on the Homer Spit were replaced due to rusting from saltwater spray conditions. The remaining will be replaced in 2019.
- Approximately 162 miles of distribution line were recleared in 2018.



- Used an underground cable injection technique to rejuvenate more than 125,000 feet of cable. This extends the life of the cable another 40 years.

SUBSTATION & METERING CAPITAL UPGRADE PROJECTS

- Tesoro Substation Expansion – HEA line crews and substation technicians assisted Northern Power Line Constructors in the installation of an additional station transformer to complete Tesoro's expansion project.
- HEA substation technicians replaced an undersized battery bank at Soldotna Substation.
- A new 115kV circuit switcher and a Two-Way Automatic Communications Metering System (TWACS) was installed at the Anchor Point Substation.
- HEA meter technicians installed more than 800 Advanced Metering Infrastructure (AMI) TWACS meters, replacing the out-of-date Cannon System meters on the south side of Kachemak Bay.
- Replaced high voltage metering equipment at the Kasilof Substation

Significant time was spent on Bradley Lake Hydro maintenance projects throughout the year including repairs to buildings, generator inspections and road construction in preparation for the Battle Creek Diversion construction in 2019.



THE CHARGE IS ON: Commitment To Community

HEA plays a vital role in the communities we serve. Your cooperative supports our local youth, organizations, and businesses that make the Kenai Peninsula a great place to live and work. These are just some examples of the cooperative presence in our communities:

- Co-op Connections Program – In its first year, HEA teamed up with local businesses to offer its members discounts to participating local businesses. The program was beneficial to all, as HEA members receive a discount and local businesses receive more business and additional advertising through HEA.
- Community Meetings in Seldovia, Port Graham, Ninilchik, Kasilof, Funny River, Sterling, and Nikiski.
- 2018 Power Pledge Challenge - HEA partnered with Renewable Energy Alaska Project, Chugach Electric Association, Municipal Light & Power, Matanuska Electric Association, Alaska Electric Light & Power, Alaska Housing Finance Corporation, and ENSTAR Natural Gas Company to educate Alaskan middle school students on energy efficiency and conservation. Locally, HEA presented the Power Pledge Challenge to local middle school students on the Kenai Peninsula, which involved hands-on activities to calculate electricity use of common household appliances. There were 228 students who completed the challenge with Blaze Watson of Skyview Middle School winning the challenge from our region.
- New Energy Technology Workshops – HEA hosted its second annual New Energy Technology Workshop in November at the Kenai Peninsula College - Kachemak Bay Campus in Homer. The well-attended workshop provided an opportunity for members to learn more about solar energy, home energy efficiencies, heat pumps and electric vehicles.

THE SPARK BEHIND THE CHARGE

HEA employees are the fuel behind the cooperative's real power – the power of community. HEA employees are threads of our community fabric who contribute, participate, and volunteer in our communities. Thank you for making an impact on a daily basis and keeping us charged up every day!

Employee Retirements & Anniversaries in 2018

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

Retirements

Glenn (Sandy) West • Mark Orth • Jim Patras

Anniversaries

Randy Parrett	20 yrs	Jeremiah Mullican	10 yrs
Jim Patras	20 yrs	Joe Pedginski	10 yrs
Shelly Fraley	10 yrs	Mike Salzetti	10 yrs
Bruce Linton	10 yrs	Mike Tracy	10 yrs
Lian McMillan	10 yrs		



TREASURER'S ANNUAL REPORT

Organized as a rural electric cooperative, Homer Electric Association Inc. operates as a not-for-profit entity under section 501(c)12 of the Internal Revenue Code. 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 members in the form of capital credit retirements. HEA is pleased to resume an annual capital credit retirement program. In 2018, approximately 9,000 current and former members received \$1.7 million in capital credit checks, plus another \$0.5 million in estate retirements.

In 2018, Homer Electric's financial position remained stable as we experienced decreasing kilowatt hour sales and increased outages. Through diligent

monitoring and expense management, we continue to meet financial obligations required by our lenders. Our number one priority is to provide safe, reliable electricity at fair and reasonable prices to you, our members.

Homer Electric concluded the year 2018 with total consolidated operating revenues of \$98 million. That total less consolidated costs of electric service of \$95 million and non-operating margins of \$1 million, resulted in a positive margin of \$4 million. The following is a financial summary for the year.



Ed Oberts
Treasurer

Energy Sales



Homer Electric sold 452 million kilowatt-hours of electricity in 2018, which is a decrease of six percent compared to the year 2017. Kilowatt-hours (kWh) sold for all classes of members experienced a decrease, with the largest decrease of eleven percent coming from industrial sales.

Revenues

Revenue generated from energy sales totaled \$97 million, a decrease of almost two percent from the previous year. Other operating revenue of \$1 million, primarily rentals and fees, plus \$1 million from non-operating interest income and capital credit allocations from other organizations, all contribute to net margins.

Cost of Power Adjustment (COPA)

The variable cost of fuel and other sources of power used to generate your electricity are reflected on your bill as the COPA charge. This rate is adjusted quarterly primarily based on the cost and source of fuel used. The average COPA rate in 2018 was 7.3 cents/kWh.

Average Residential Member Monthly Bill

(based on 550 kWh as of December 31 2016-2018)



Expenses

In 2018, total expenses were \$95 million, increasing less than one percent compared to 2017. Fuel and purchased power costs stayed very level and comprised thirty-six percent of total expenses. Operating costs increased less than \$1 million, just over one percent from 2017.

Where Your Dollar Went



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 2017 was forty-one percent. The same ratio for Alaska Electric & Energy Cooperative (AEEC), Homer Electric's subsidiary, which owns our generation and transmission assets, was sixteen and one half percent in 2018, up from fifteen percent in 2017.

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. Annually, the Board of Directors considers the general retirement of capital credits. Thanks to healthy equity levels, the Board authorized \$1.952 million for retirement in 2019, marking the third consecutive year.

Financial Goals

In conclusion, Homer Electric met its financial goals with positive margins and met required loan agreement ratios in 2018. 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 Balance Sheets, Unaudited

December 31,	2018	2017
Assets		
Utility Plant at Cost		
Electric plant in service	\$ 597,669,211	\$ 590,535,539
Electric plant held for future use	1,166,067	1,166,067
Construction work in progress	6,808,924	7,866,936
Total utility plant at cost	605,644,202	599,568,542
Less accumulated depreciation and amortization	(206,406,131)	(196,451,530)
Net Utility Plant	399,238,071	403,117,012
Other Assets and Investments		
Investments in associated organizations	20,344,937	22,187,694
Notes receivable, net of current portion	256,015	321,904
Non-utility property, net of accumulated depreciation of \$585,027 (\$549,331 in 2017)	160,085	195,781
Total Other Assets and Investments	20,761,037	22,705,379
Current Assets		
Cash and cash equivalents	3,898,971	4,063,658
Accounts receivable, less allowance for doubtful accounts of \$171,436 (\$107,295 in 2017)	7,997,128	7,752,458
Unbilled revenue	6,375,977	6,112,933
Materials, fuel and supplies inventory	7,617,357	6,548,092
Notes receivable, current portion	181,246	267,138
Other current and accrued assets	1,482,130	3,019,896
Total Current Assets	27,552,809	27,764,175
Deferred Charges	4,006,639	3,743,407
Total Assets	\$ 451,558,556	\$ 457,329,973

Homer Electric Association, Inc. and Subsidiary
Consolidated Balance Sheets, continued

December 31,	2018	2017
Equities and Liabilities		
Equities		
Memberships	\$ 47,025	\$ 48,820
Patronage capital	97,086,108	95,664,080
Other equities - donated capital	3,747,606	3,251,715
Total Equities	100,880,739	98,964,615
Liabilities		
Long-term Debt - mortgage notes payable	319,960,828	331,568,039
Current Liabilities		
Current portion of long-term debt	17,493,495	16,118,989
Notes payable	1,000,000	-
Accounts payable	6,158,919	4,915,072
Consumer deposits	1,308,359	1,223,154
Accrued payroll and benefits	2,543,198	2,483,930
Accrued taxes and other current liabilities	1,337,686	1,348,181
Total Current Liabilities	29,841,657	26,089,326
Deferred Credits	875,332	707,993
Total Equities and Liabilities	\$ 451,558,556	\$ 457,329,973

Homer Electric Association, Inc. and Subsidiary
Consolidated Statements of Operations and Patronage Capital, Unaudited

Years Ended December 31,	2018	2017
Operating Revenues	\$ 97,876,247	\$ 99,650,323
Operating Expenses		
Fuel costs	30,752,954	31,698,007
Production operations and maintenance	7,049,833	6,930,276
Purchased power costs	4,060,682	3,022,687
Transmission operations and maintenance	1,491,910	1,236,977
Distribution operations and maintenance	8,244,752	7,221,640
Consumer accounts, service and sales	3,852,265	3,688,744
Administrative, general and other	9,071,818	9,808,904
Depreciation and amortization	17,655,194	17,771,472
Total Operating Expenses	82,179,408	81,378,707
Interest Expense		
Long-term debt and other	13,428,560	13,520,569
Allowance for funds used during construction	(153,176)	(232,339)
Net Interest Expense	13,275,384	13,288,230
Net operating margins	2,421,455	4,983,386
Nonoperating Margins		
Interest income	365,219	183,623
Loss on sale of assets	(2,613)	(33,583)
Other income (expense)	134,998	(970)
Capital credits, patronage dividends and other	731,373	693,407
Total Nonoperating Margins	1,228,977	842,477
Net margins	3,650,432	5,825,863
Patronage capital, beginning of year	95,664,080	91,592,274
Less retirement of patronage capital credits	(2,228,404)	(1,754,057)
Patronage Capital, end of year	\$ 97,086,108	\$ 95,664,080