SOUTHERN MINNESOTA MUNICIPAL POWER AGENCY

Financial Statements

December 31, 2016 and 2015

(With Independent Auditors' Report Thereon)

SOUTHERN MINNESOTA MUNICIPAL POWER AGENCY

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KPMG LLP
4200 Wells Fargo Center
90 South Seventh Street
Minneapolis, MN 55402

Independent Auditors' Report

The Board of Directors
Southern Minnesota Municipal Power Agency:

We have audited the accompanying financial statements of Southern Minnesota Municipal Power Agency (the Agency) as of and for the years ended December 31, 2016 and 2015, and the related notes to the financial statements, which collectively comprise the Agency's basic financial statements for the years then ended as listed in the table of contents.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the 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 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 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 financial statements referred to above present fairly, in all material respects, the financial position of the Agency as of December 31, 2016 and 2015, and the changes in its financial position and its cash flows for the years then ended, in accordance with U.S. generally accepted accounting principles.

KPMG LLP is a Delaware limited liability partnership and the U.S. member
firm of the KPMG network of independent member firms affiliated with
KPMG International Cooperative ("KPMG International"), a Swiss entity.

Other Matter

U.S. generally accepted accounting principles require that the management's discussion and analysis on pages 3 through 13, the schedule of the Agency's proportionate share of net pension liability on page 39, and the schedule of the Agency's contributions on page 40, be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

KPMG LLP

Minneapolis, Minnesota
April 7, 2017

Financial Statements Overview

This discussion and analysis of Southern Minnesota Municipal Power Agency's (the Agency) financial performance provides an overview of the Agency's activities for the fiscal years ended December 31, 2016 and 2015. The information presented should be read in conjunction with the basic financial statements and the accompanying notes to the financial statements.

The basic financial statements are prepared on the accrual basis of accounting in accordance with U.S. generally accepted accounting principles. The Agency complies with all applicable pronouncements of the Governmental Accounting Standards Board (GASB). This includes GASB Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*. GASB Statement No. 62 incorporates into the GASB's authoritative literature certain accounting and financial reporting guidance that is included in Financial Accounting Standards Board and American Institute of Certified Public Accountant pronouncements issued on or before November 30, 1989, which does not conflict with GASB pronouncements. The Agency also follows the guidance of GASB Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*. The Agency follows the Uniform System of Accounts prescribed by the Federal Energy Regulatory Commission.

The Agency adopted GASB Statement No. 68, *Accounting and Financial Reporting for Pensions*, in 2015. The purpose of the standard is to improve the transparency of the pension obligation, and related funding status, by presenting the Agency's share of the Public Employee Retirement Association of Minnesota (PERA) net pension liability on the Agency's statements of net position. This standard also changed how funding is recognized, and changed the elements of pension expense. However, the funding requirements were not impacted by this standard; only the manner in which the funding is recognized in the financial statements. The most significant impact of the adoption of this standard is the recognition of the net pension liability of $6.5 million and $4.4 million at December 31, 2016 and 2015, respectively.

The accounting for pension activity under the new standard results in deferred outflows (delayed recognition of unfavorable investment income changes or unfavorable actuarial changes) and deferred inflows (delayed recognition of favorable investment income changes or favorable actuarial changes). These changes will be amortized into net pension expense over five years for investment-related deferrals, and four years for actuarially determined deferrals beginning in the year in which the inflow or outflow is initially recognized.

Effective January 1, 2016, the Agency has adopted GASB Statement No. 72, *Fair Value Measurement and Application.* This standard generally requires all investments to be measured at fair value. The Statement also requires disclosures to be made about fair value measurements, the level of fair value hierarchy, and valuation techniques. The Agency has organized these disclosures by type of asset or liability reported at fair value.

The Agency's basic financial statements include the statements of net position; the statements of revenues, expenses, and changes in net position; and the statements of cash flows. The statements of net position provide information about the nature and amount of assets and obligations (liabilities) of the Agency as of December 31, 2016 and 2015. The statements of revenues, expenses, and changes in net position report revenues and expenses for the years ended December 31, 2016 and 2015. The statements of cash flows report cash receipts, cash payments, and net changes in cash resulting from operating activities, noncapital financing activities, capital and related financing activities, and investing activities.

Summary of Significant Capital and Financing Activities

The Agency has a number of capital projects with an existing and/or ongoing effect on the financial statements. A brief summary of each is as follows:

Owatonna Energy Station

At its March 2015 meeting, the Agency's board approved construction of a 38 MW high-efficiency natural gas fired generating station near Owatonna, Minnesota. The project will consist of four 20-cylinder Caterpillar internal combustion engines and is estimated to cost approximately $44.0 million to complete. The site was purchased and construction was underway at the end of 2016. Construction work in progress (CWIP) included $28.3 million for the project at the end of 2016. Construction will be funded by the Agency's commercial paper program and cash reserves. The board and Members approved financing for the project in the form of revenue bonds, which will be issued following completion.

CapX 2020

The Agency has a 13% undivided ownership share of the CapX 2020 Hampton to La Crosse transmission line, which was completed and is now fully energized. The Agency's ownership share is in the 345 kV and 161 kV facilities in the project. The line runs south from a new substation near Hampton, Minnesota, to a substation near Pine Island, Minnesota (the North Rochester substation), and east into Wisconsin to a substation called Briggs Road, which is located north of La Crosse, Wisconsin. Capital expenditures incurred by the Agency in 2016 pertaining to this project were approximately $6.7 million. CWIP of $36.8 million pertaining to the completed portions of the project was transferred to completed-not-classified plant in service during 2016 and $29.0 million of completed-not-classified plant in service was transferred to plant and equipment.

Other Capital Projects

- **Badger Coulee Transmission Project**

  Approval of the request by SMMPA Wisconsin LLC (the LLC), a wholly owned subsidiary of the Agency, to be declared a public utility in Wisconsin was granted by the Public Service Commission of Wisconsin in February 2015. The Agency is the sole member of the LLC. The LLC will own a 6.5% undivided ownership interest in the Badger Coulee 345 kV transmission line extending from the Briggs Road substation near La Crosse, Wisconsin, to the North Madison substation near Madison, Wisconsin. This project will require an estimated $32.5 million investment by the LLC. The Agency's board of directors approved participation in the project in May 2015. The board and Members also approved financing for the project at their May 2015 meetings. The Agency currently expects that it will provide the financing for the project under a project bond resolution approved by the board at its August 2015 meeting. The project-based financing will allow the flexibility for certain Members whose power sales contracts expire in 2030 to participate in the Badger Coulee project as project participants beyond the expiration of their power sales contracts. The project is designated as a multi-value project by the Midcontinent Independent System Operator (MISO). At its May 2016 meeting the Agency's board approved a three year direct purchase and drawdown loan program with U.S. Bank for construction of the Agency's share of the project. As of December 31, 2016, the LLC has incurred $6.8 million of capital expenditures.

Agency Financings and Wholesale Power Rate Action

The Agency entered into a Continuing Covenants Agreement (CCA), Southern Minnesota Municipal Power Agency Badger Coulee Project Revenue Bonds, 2016 Series A, with U.S. Bank on May 25, 2016 under the project bond resolution approved in August of 2015. The CCA allows U.S. Bank to provide short term construction financing for the Badger Coulee transmission project up to $35,000,000 with a 3 year term with an option to extend the agreement. The financing is in the form of a loan made by U.S. Bank as a condition of the Agency issuing variable rate bonds, which are then purchased directly by the bank. The Notes shall bear interest at a per annum rate of interest equal to the sum of (i) the Bank Index times an Applicable Factor and (ii) the Applicable Spread (the *"Index Rate"),* subject to adjustment, along with a fee on the unused portion of the program. The Bank Index shall be one-month LIBOR, which shall be reset on the first day of each calendar month based upon LIBOR two New York Business Days prior to each such rate date. The Notes shall bear interest at the Index Rate so long as no Event of Taxability or Event of Default has occurred. The Agency currently had $5 million outstanding at the end of 2016.

Wholesale Power and Energy Rate Action

On October 14, 2016, the Agency's board of directors approved a 1% wholesale rate increase effective February 1, 2017 and a rate structure change by moving the starting time for the on-peak period for energy rates to 8 a.m. from 10 a.m. each peak day, and to add Good Friday as a peak day consistent with the MISO tariff. The rate structure change is expected to result in an additional 1% increase in revenues.

Financial Highlights – 2016

Condensed Statements of Net Position
($millions)

Assets		2016	2015	2016 to 2015 change
Current assets	$	214.0	222.4	(8.4)
Noncurrent assets:				
Capital assets, net		502.9	488.7	14.2
Noncurrent investments		74.1	74.4	(0.3)
Future recoverable costs		193.0	207.8	(14.8)
Deferred outflows:				
Deferred outflows – advance refunding of debt		9.1	15.0	(5.9)
Deferred outflows of pension resources		3.1	0.5	2.6
Accumulated decrease in fair value of derivative instruments – noncurrent		0.2	0.6	(0.4)
Total assets and deferred outflows	$	996.4	1,009.4	(13.0)
Liabilities				
Current liabilities	$	127.5	115.2	12.3
Long-term liabilities:				
Long-term debt, net		595.3	634.7	(39.4)
Derivative instruments – swap liability		0.2	0.6	(0.4)
Pension liability		6.5	4.4	2.1
Deferred inflows:				
Deferred credits rate stabilization		94.5	88.3	6.2
Deferred gain on involuntary conversion of plant assets		58.6	61.8	(3.0)
Deferred inflows of pension resources		1.4	0.9	0.5
Total liabilities and deferred inflows		884.0	905.9	(21.7)
Net position:				
Invested in capital assets		169.7	108.4	61.3
Restricted		66.9	62.8	4.1
Unrestricted		(124.2)	(67.7)	(56.5)
Total net position		112.4	103.5	8.9
Total liabilities, deferred inflows, and net position	$	996.4	1,009.4	(13.0)

(Continued)

Condensed statements of net position highlights are as follows:

- The assets and deferred outflows of the Agency exceeded its liabilities and deferred inflows at the close of 2016 by approximately $112.4 million.
- Current assets decreased by approximately $8.4 million in 2016. Current assets include deposits and investments held in revenue and operating funds of approximately $31.1 million at December 31, 2016 to be used for operating, maintenance, and working capital needs of the Agency, and increased by approximately $1.2 million in 2016. Current assets at December 31, 2016 also include deposits and investments held in restricted funds of approximately $72.4 million in accordance with the bond resolution for debt service requirements, which decreased by approximately $5.3 million.
- Current assets included an increase of approximately $6.8 million in fuel stock, a decrease of approximately $13.8 million in other unrestricted funds and an increase of approximately $1.4 million in power sales revenue receivables.
- Capital assets, net, increased by approximately $14.2 million during 2016. Capital assets, net, include the Agency's 41% undivided ownership interest in Sherco 3 plant with a historical cost of approximately $560.2 million as of December 31, 2016. The Agency also has approximately $264.1 million on a historical cost basis of Agency-owned generating facilities, substation facilities, transmission lines, land, wind turbines, buildings, upgrades to Members' generating units under contract, and general office equipment recorded as of the end of 2016.
- For 2016, the increase in capital assets, net, was the result of an increase in electric plant and equipment, net, of approximately $17.3 million and a net decrease in construction work in progress of approximately $3.2 million. The increase in electric plant and equipment, net, was a result of an increase of approximately $37.0 million for the construction of transmission assets, and a decrease of approximately $0.5 million in Sherco 3 and other capital improvements, offset by an increase in accumulated depreciation of approximately $19.2 million.
- Noncurrent investments, which include investments held in restricted funds in accordance with the bond resolution for debt service reserves, were approximately $74.1 million in 2016.
- Future recoverable costs represent costs in excess of the amounts currently billable to the Members that are to be recovered from future revenues by setting rates sufficient to provide funds for the related debt service payments, the balance decreased by approximately $14.8 million in 2016.
- Deferred outflows – Advance refunding of debt decreased by $5.9 million as a result of the combined effects of amortization and deferred outflows resulting from the advance refunding of callable Series 2006A and 2009A revenue bonds in 2016.
- Deferred outflows of pension resources for 2016 were $3.1 million. The deferred inflows and outflows of pension resources are amounts used under GASB Statement No. 68 in developing the annual pension expense. Deferred inflows and outflows arise with differences between expected and actual experiences and changes of assumptions.

(Continued)

- Current liabilities increased by approximately $12.3 million in 2016. The current portion of long-term debt of approximately $60.1 million at December 31, 2016 and notes payable of $40.0 million are included in current liabilities. Attributable to the total increase in total current liabilities was a $2.0 million increase in accounts payable – power production, a $1.0 million increase in accrued liabilities and other payables, an increase of approximately $4.4 million in current maturities of long-term debt, and an increase in notes payable of $5.0 million.
- The carrying value of long-term debt at the end of 2016 was approximately $595.3 million. Scheduled principal payments of approximately $55.7 million were made in 2016.
- Pension liability was approximately $6.5 million at the end of 2016, an increase of approximately $2.2 million during 2016.
- Deferred inflows, current and long-term deferred credits rate stabilization, increased by approximately $6.1 million. The increase was a result of net contributions to the account during 2016.
- Deferred inflows, gain on involuntary conversion of plant assets, current and long-term decreased by approximately $3.3 million in 2016.
- Deferred inflows of pension resources was approximately $1.4 million at the end of 2016. The deferred inflows and outflows of pension resources are amounts used under GASB Statement No. 68 in developing the annual pension expense. Deferred inflows and outflows arise with differences between expected and actual experiences and changes of assumptions.

Condensed Statements of Revenues, Expenses, and Changes in Net Position

($ millions)

	2016	2015	2016 to 2015 change
Operating revenues, power sales	$ 235.7	231.6	4.1
Other revenues	2.8	2.8	—
Total revenues	238.5	234.4	4.1
Operating expenses	183.9	179.6	4.3
Interest expense, net	45.7	44.9	0.8
Total expenses	229.6	224.5	5.1
Change in net position	8.9	9.9	(1.0)
Beginning net position	103.5	98.4	5.1
Adjustments to net position related to pensions	—	(4.8)	4.8
Ending net position	$ 112.4	103.5	8.9

(Continued)

Condensed statements of revenues, expenses, and changes in net position highlights are as follows:

- Operating revenues, power sales, increased by approximately $4.1 million between 2016 and 2015. Operating revenues, power sales, consist principally of Member power sales revenue, power sales to nonmembers, other transmission revenue, and contributions to, or distributions from, the rate stabilization account. Sales to nonmembers include the Agency's participation in the MISO Day 2 market.
- In 2016, before the effects of contributions made to the rate stabilization account, operating revenues, power sales, increased by approximately $14.8 million, primarily due to increases in the Member sales of $14.1 million, decreases in MISO energy market sales of $1.4 million, and an increase in transmission service agreement revenues by $2.1 million. There was a net contribution of approximately $6.1 million to the rate stabilization account in 2016 compared with a net distribution of approximately $4.6 million in 2015. Contributions to the rate stabilization account decrease the amount of operating revenues, power sales, whereas distributions from the rate stabilization account increase the amount of operating revenues, power sales as funds are added to, or subtracted from, the rate stabilization account, which is included in deferred inflows.
- There was no change in other revenues between 2016 and 2015. Other revenues include the Build America Bonds (BABs) interest subsidy and rental income.
- Operating expenses increased by approximately $4.3 million between 2016 and 2015. Operating expenses consist of production fuel, power production, other operating expenses, depreciation and amortization, and expenses to be recovered in future periods. The increase observed in 2016, compared with 2015, was the net result of a decrease in production fuel expense of approximately $12.8 million due to reduced Sherco 3 dispatch as a function of energy market prices, an increase in power production expenses of approximately $10.7 million reflecting increased energy market purchases, an increase in other operating expenses of approximately $3.4 million (consisting mainly of an increase of approximately $3.4 million in transmission expenses, a decrease of approximately $0.6 million in Sherco 3 operating and maintenance expenses, an increase of approximately $0.6 million in administrative and general expenses) and a combined increase of approximately $3.0 million in depreciation and deferred costs expensed in current period.

Financial Highlights – 2015

Condensed Statements of Net Position
($ millions)

		2015	2014	2015 to 2014 change
Assets				
Current assets	$	222.4	216.1	6.3
Noncurrent assets:				
Capital assets, net		488.7	477.7	11.0
Noncurrent investments		74.4	72.0	2.4
Future recoverable costs		207.8	220.3	(12.5)
Deferred outflows:				
Deferred outflows – advance refunding of debt		15.0	16.3	(1.3)
Deferred outflows of pension resources		0.5	—	0.5
Accumulated decrease in fair value of derivative instruments – noncurrent		0.6	0.7	(0.1)
Total assets and deferred outflows	$	1,009.4	1,003.1	6.3
Liabilities				
Current liabilities	$	115.2	137.5	(22.3)
Long-term liabilities:				
Long-term debt, net		634.7	608.7	26.0
Derivative instruments – swap liability		0.6	0.7	(0.1)
Pension liability		4.4	—	4.4
Deferred inflows:				
Deferred credits rate stabilization		88.3	93.0	(4.7)
Deferred gain on involuntary conversion of plant assets		61.8	64.8	(3.0)
Deferred inflows of pension resources		0.9	—	0.9
Total liabilities and deferred inflows		905.9	904.7	1.2
Net position:				
Invested in capital assets		108.4	95.1	13.3
Restricted		62.8	66.8	(4.0)
Unrestricted		(67.7)	(63.5)	(4.2)
Total net position		103.5	98.4	5.1
Total liabilities, deferred inflows, and net position	$	1,009.4	1,003.1	6.3

Condensed statements of net position highlights are as follows:

- The assets and deferred outflows of the Agency exceeded its liabilities and deferred inflows at the close of 2015 by approximately $103.5 million.
- Current assets increased by approximately $6.3 million in 2015. Current assets include deposits and investments held in revenue and operating funds of approximately $29.9 million at December 31, 2015 to be used for operating, maintenance, and working capital needs of the Agency, and increased by approximately $2.2 million in 2015. Current assets at December 31, 2015 also include deposits and investments held in restricted funds of approximately $77.7 million in accordance with the bond resolution for debt service requirements.
- Current assets included a decrease of $11.2 million in the insurance claim receivable in 2015 due to the final payment from the insurance companies for damage to the Agency's 41% undivided ownership in the Sherburne County Generating Unit No. 3 (Sherco 3) experienced in the 2011 generator and turbine catastrophic failure.
- Capital assets, net, increased by approximately $11.0 million during 2015. Capital assets, net, include the Agency's 41% undivided ownership interest in Sherco 3 plant with a historical cost of approximately $560.7 million as of December 31, 2015. The Agency also has approximately $227.1 million on a historical cost basis of Agency-owned generating facilities, substation facilities, transmission lines, land, wind turbines, buildings, upgrades to Members' generating units under contract, and general office equipment recorded as of the end of 2015. In addition, the Agency capitalizes improvements made to member owned generation under Agency contract.
- For 2015, the increase in capital assets, net, was the result of an increase in electric plant and equipment, net, of approximately $26.4 million and a net increase in construction work in progress of approximately $0.6 million. The increase in electric plant and equipment, net, was a result of an increase of approximately $8.6 million for Sherco 3 repairs and capital improvements made, an increase of approximately $16.6 million for the construction of transmission assets, and an increase of approximately $1.2 million in other capital improvements, offset by an increase in accumulated depreciation of approximately $16.1 million.
- Noncurrent investments, which include investments held in restricted funds in accordance with the bond resolution for debt service reserves, were approximately $74.4 million in 2015.
- Deferred outflows, future recoverable costs – noncurrent, consisting of costs in excess of the amounts currently billable to the Members that are to be recovered from future revenues by setting rates sufficient to provide funds for the related debt service payments, decreased by approximately $12.5 million in 2015.
- Deferred outflows – Advance refunding of debt decreased by $1.3 million as a result of the combined effects of amortization and deferred outflows resulting from the advance refunding of callable Series 2006A and 2009A revenue bonds in 2015.
- Deferred outflows of pension resources for 2015 were $0.5 million. The deferred inflows and outflows of pension resources are amounts used under GASB Statement No. 68 in developing the annual pension expense. Deferred inflows and outflows arise with differences between expected and actual experiences and changes of assumptions.
- Current liabilities decreased by approximately $22.3 million in 2015. The current portion of long-term debt of approximately $55.7 million at December 31, 2015 and commercial paper notes payable of $35.0 million are included in current liabilities. Attributable to the total decrease in total current liabilities was a $0.2 million increase in accounts payable – power production, a $14.7 million decrease in accrued liabilities and other

payables, an increase of approximately $3.8 million in current maturities of long-term debt, offset by a decrease of approximately $1.6 million in accrued interest payable and a decrease in commercial paper notes payable of $10.0 million. The decrease in accrued liabilities of approximately $14.7 million is primarily due to the termination of a $12.6 million liability for the Agency's obligation under a shared transmission system agreement with Dairyland Power Cooperative. Under terms of a memorandum of understanding with Dairyland, the liability was settled by the end of 2015.

- The carrying value of long-term debt at the end of 2015 was approximately $634.7 million. Scheduled principal payments of approximately $51.9 million were made in 2015. On October 14, 2015, the Agency issued $97.8 million of bonds and refunded $50.4 million in bonds. The carrying value of the long-term debt was also impacted by the effect of bond discount/premium amortization.
- Pension liability was approximately $4.4 million at the end of 2015, due to the adoption of GASB Statement No. 68.
- Deferred inflows, current and long-term deferred credits rate stabilization, decreased by approximately $4.6 million. The decrease was a result of net distribution from the account during 2015.
- Deferred inflows, gain on involuntary conversion of plant assets, current and long-term decreased by approximately $3.0 million in 2015.
- Deferred inflows of pension resources was approximately $0.9 million at the end of 2015. The deferred inflows and outflows of pension resources are amounts used under GASB Statement No. 68 in developing the annual pension expense. Deferred inflows and outflows arise with differences between expected and actual experiences and changes of assumptions.

Condensed Statements of Revenues, Expenses, and Changes in Net Position

(Dollars in millions)

		2015	2014	2015 to 2014 Change
Operating revenues, power sales	$	231.6	242.1	(10.5)
Other revenues		2.8	2.5	0.3
Total revenues		234.4	244.6	(10.2)
Operating expenses		179.6	190.5	(10.9)
Interest expense, net		44.9	44.6	0.3
Total expenses		224.5	235.1	(10.6)
Change in net position		9.9	9.5	0.4
Beginning net position		98.4	88.9	9.5
Adjustments to net position related to pensions		(4.8)	—	(4.8)
Ending net position	$	103.5	98.4	5.1

Condensed statements of revenues, expenses, and changes in net position highlights are as follows:

- Operating revenues, power sales, decreased by approximately $10.5 million between 2015 and 2014. Operating revenues, power sales, consist principally of Member power sales revenue, power sales to nonmembers, other transmission revenue, and contributions to, or distributions from, the rate stabilization account. Sales to nonmembers include the Agency's participation in the MISO Day 2 market.
- In 2015, before the effects of contributions made to the rate stabilization account, operating revenues, power sales, decreased by approximately $15.6 million, primarily due to decreases in the Member sales of $1.7 million, decreases in MISO energy market sales of $12.9 million, and a decrease in transmission service agreement revenues by $1.0 million. There was a net distribution of approximately $4.6 million from the rate stabilization account in 2015 compared with a net contribution of approximately $0.5 million in 2014. Contributions to the rate stabilization account decrease the amount of operating revenues, power sales, whereas distributions from the rate stabilization account increase the amount of operating revenues, power sales as funds are added to, or subtracted from, the rate stabilization account, which is included in deferred inflows.
- Other revenues increased by approximately $0.3 million between 2015 and 2014. Other revenues include the Build America Bonds (BABs) interest subsidy and rental income.
- Operating expenses decreased by approximately $10.9 million between 2015 and 2014. Operating expenses consist of production fuel, power production, other operating expenses, depreciation and amortization, and expenses to be recovered in future periods. The decrease observed in 2015, compared with 2014, was the net result of a decrease in production fuel expense of approximately $4.1 million due to reduced Sherco 3 dispatch as a function of energy market prices and mild weather, a decrease in power production expenses of approximately $12.0 million reflecting reduced energy market purchases, an increase in other operating expenses of approximately $3.6 million (consisting mainly of an increase of approximately $3.1 million in transmission expenses, a decrease of approximately $1.5 million in Sherco 3 operating and maintenance expenses, an increase of approximately $1.7 million in demand side management expenses, and net changes in other expenses totaling an increase of $0.3 million) and a combined increase of approximately $1.6 million in depreciation and expenses to be recovered in future periods.

Debt Administration

As of December 31, 2016 and 2015, the carrying value of the Agency's total long-term debt outstanding, including current maturities, was approximately $655.4 million and $690.3 million, respectively. The decrease in 2016 was the net result of scheduled amortization of long-term debt and the bond discount/premium amounts. Current liabilities include Notes Payable of $40 million as of December 31, 2016 and $35.0 million in 2015. Notes payable consisted of $35 million in short-term commercial paper notes outstanding as of December 31, 2016 and December 31, 2015. The December 31, 2016 amount includes $5.0 million advanced from the CCA for construction of the Badger Coulee project.

Contact Information

This financial report is designed to provide a general overview of the Agency's finances. Questions or requests for additional information should be addressed to the Director of Finance and Accounting & CFO, 500 First Avenue Southwest, Rochester, Minnesota 55902.

SOUTHERN MINNESOTA MUNICIPAL POWER AGENCY

Statements of Net Position

December 31, 2016 and 2015

Assets	2016	2015
Current assets:		
Cash	$ 42,533	230,534
Investments:		
Unrestricted funds:		
Revenue and operating funds	31,083,103	29,854,848
Rate stabilization	65,955,166	65,122,923
Other	552,805	14,381,580
Restricted funds	72,401,682	77,656,634
Power sales revenue receivables	17,253,702	15,837,984
Accrued interest receivable	537,350	330,150
Fuel stock	17,978,428	11,130,656
Material inventory	5,831,031	5,771,894
Prepaids	1,330,129	1,245,652
Other current assets	506,111	827,422
Escrow deposit	558,614	—
Total current assets	214,030,654	222,390,277
Noncurrent assets:		
Capital assets:		
Electric plant and equipment	824,297,175	787,759,867
Less accumulated depreciation and amortization	371,696,808	352,472,311
Electric plant and equipment – net	452,600,367	435,287,556
Construction work in progress	50,252,596	53,426,177
Total capital assets	502,852,963	488,713,733
Noncurrent investments:		
Restricted investment funds	74,116,710	74,371,800
Future recoverable costs	193,010,775	207,820,837
Total noncurrent assets	769,980,448	770,906,370
Total assets	984,011,102	993,296,647
Deferred Outflows		
Deferred outflows of pension resources	3,061,538	498,077
Deferred outflows – advance refunding of debt	9,126,153	14,966,511
Accumulated decrease in fair value of derivative instruments – noncurrent	182,480	608,287
Total assets and deferred outflows	$ 996,381,273	1,009,369,522
Liabilities		
Current liabilities:		
Accounts payable – power production	$ 4,849,603	2,874,563
Accrued liabilities and other payables	16,596,040	15,579,655
Accrued interest payable	5,954,348	6,017,605
Notes payable	40,000,000	35,000,000
Current maturities of long-term debt	60,090,000	55,695,000
Total current liabilities	127,489,991	115,166,823
Long-term liabilities:		
Long-term debt, net	595,267,058	634,631,301
Derivative instruments – swap liability	182,480	608,287
Pension liability	6,519,962	4,384,411
Total long-term liabilities	601,969,500	639,623,999
Total liabilities	729,459,491	754,790,822
Deferred Inflows		
Deferred credits rate stabilization – current	8,594,128	149,761
Gain on involuntary conversion of plant assets – current	3,254,989	3,254,989
Deferred credits rate stabilization – noncurrent	85,882,506	88,207,046
Gain on involuntary conversion of plant assets – noncurrent	55,334,821	58,589,810
Deferred inflows of pension resources	1,446,773	919,743
Total deferred inflows	154,513,217	151,121,349
Total liabilities and deferred inflows	883,972,708	905,912,171
Net Position		
Net investment in capital assets	169,712,848	108,399,593
Restricted by bond agreements	66,932,173	62,765,576
Unrestricted	(124,236,456)	(67,707,818)
Total net position	112,408,565	103,457,351
Total liabilities, deferred inflows, and net position	$ 996,381,273	1,009,369,522

See accompanying notes to financial statements.

SOUTHERN MINNESOTA MUNICIPAL POWER AGENCY

Statements of Revenues, Expenses, and Changes in Net Position

Years ended December 31, 2016 and 2015

	2016	2015
Operating revenues, power sales	$ 235,715,851	231,618,307
Operating expenses:		
Production fuel	29,488,186	42,317,338
Power production	66,118,557	55,415,423
Other operating expenses	63,549,666	60,140,350
Depreciation and amortization	18,159,671	16,289,136
Deferred costs expensed in current period	6,552,723	5,426,104
Total operating expenses	183,868,803	179,588,351
Operating income	51,847,048	52,029,956
Nonoperating (income) expenses:		
Investment earnings	(1,598,375)	(1,374,378)
Miscellaneous income	(1,223,972)	(1,443,794)
Interest expense	10,340,579	10,984,149
Amortization of long-term debt issuance costs	969,608	1,036,655
Amortization of discount/premium on long-term debt	26,566,116	26,236,035
Deferred costs expensed in current period	7,841,878	6,707,069
Total nonoperating expenses	42,895,834	42,145,736
Change in net position	8,951,214	9,884,220
Total net position, beginning of year	103,457,351	98,390,713
Adjustment to net position related to pension (notes 1 and 7)	—	(4,817,582)
Total net position, end of year	$ 112,408,565	103,457,351

See accompanying notes to financial statements.

SOUTHERN MINNESOTA MUNICIPAL POWER AGENCY

Statements of Cash Flows

Years ended December 31, 2016 and 2015

	2016	2015
Cash flows from operating activities:		
Receipts from Members	$ 210,387,061	198,119,355
Receipts from others	30,354,211	29,774,231
Payments for fuel	(36,335,958)	(47,000,584)
Payments for other power production	(64,202,654)	(55,256,568)
Payments for other operating expenses	(50,922,426)	(50,437,150)
Payments for maintenance	(6,961,803)	(7,237,315)
Payments in-lieu of property taxes	(4,634,410)	(4,647,951)
Net cash provided by operating activities	77,684,021	63,314,018
Cash flows from noncapital financing activity:		
Miscellaneous income	1,223,972	1,443,794
Net cash provided by noncapital financing activity	1,223,972	1,443,794
Cash flows from capital and related financing activities:		
Capital asset additions	(33,789,849)	(29,574,123)
Proceeds from issuance of notes payable	5,000,000	23,000,000
Cash paid to retire notes payable	—	(33,000,000)
Proceeds from issuance of revenue bonds	—	113,047,102
Retirement of long-term debt	—	(50,415,000)
Cash paid for bond issuance costs	—	(6,365,280)
Principal payments for long-term debt	(55,695,000)	(51,935,000)
Interest payments	(12,167,878)	(14,662,686)
Net cash used in capital and related financing activities	(96,652,727)	(49,904,987)
Cash flows from investing activities:		
Proceeds from sale/maturity of investments	356,595,437	208,263,612
Purchase of investments	(339,871,265)	(224,301,522)
Interest received	1,391,175	1,392,085
Escrow deposit	(558,614)	—
Net cash provided by (used in) investing activities	17,556,733	(14,645,825)
Change in cash	(188,001)	207,000
Cash, beginning balance	230,534	23,534
Cash, ending balance	$ 42,533	230,534
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	$ 51,847,048	52,029,956
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation and amortization	18,159,671	16,289,136
Deferred costs expensed in current period	6,552,723	5,426,104
Change in deferred credits	6,119,827	(4,602,996)
Pension	99,120	(11,504)
Changes in operating assets and liabilities:		
Power sales revenue receivables	(1,415,718)	491,856
Fuel stock	(6,847,772)	(4,683,246)
Material inventory	(59,137)	(16,530)
Prepaids	(84,477)	(83,091)
Other current assets	321,311	386,420
Accounts payable – power production	1,975,040	175,385
Accrued liabilities and other payables	1,016,385	(2,087,472)
Total adjustments	25,836,973	11,284,062
Net cash provided by operating activities	$ 77,684,021	63,314,018
Supplemental disclosures of noncash items:		
Capitalized interest	$ 1,764,042	2,104,606

See accompanying notes to financial statements.

(1) Organization and Significant Accounting Policies

(a) Organization and Operation

Southern Minnesota Municipal Power Agency (the Agency) was created as a municipal corporation and a political subdivision of the State of Minnesota under Minnesota Statute 453 by an agency agreement recorded with the Secretary of the State of Minnesota on June 2, 1977. The Agency's purpose is to secure an adequate, economical, and reliable supply of electric energy for its member municipalities. The Agency is made up of 18 Minnesota municipalities that purchase power from the Agency under power sales contracts.

The Agency sells power to its Members under power sales contracts that initially extended to April 1, 2030. In December 2008, the board of directors approved a request for the member cities to consider extending their contracts an additional 20 years from April 1, 2030 to April 1, 2050. Of the 18 Members, 16 have elected to extend their contracts. The board of directors approved the contract extensions in January 2011 for 15 Members and in June 2016 for one Member. The two Members that have elected not to extend their contracts are the cities of Austin and Rochester.

Under the terms of these contracts, with certain minor exceptions, the Agency is obligated to furnish, and each member is obligated to take and pay for, the total power and energy required by the member through the term of the contract. However, for the city of Rochester, the maximum amount of power required to be delivered by the Agency and taken and paid for by that member through the term of the contract is 216 megawatts. Beginning in 2016, for the city of Austin, the maximum amount of power required to be delivered by the Agency and taken and paid for by that member through the term of the contract is 70 megawatts.

The Agency owns a 41% undivided ownership interest in Sherburne County Generating Unit No. 3 (Sherco 3) with an investor-owned utility. The 41% undivided ownership interest is included in capital assets. The Agency's share of the total net tested capability of Sherco 3 is approximately 373 megawatts. The Agency also purchases some power for resale under capacity purchase agreements with its Members, who own and operate generating units.

SMMPA Wisconsin, LLC (the LLC), a blended component unit of the Agency, is undertaking investment in, and owns a 6.5% undivided interest in the Badger Coulee 345 kV transmission project in the state of Wisconsin which is expected to be completed in late 2018 or 2019. The LLC is a public utility in Wisconsin and may own utility assets in that state. The LLC will not provide retail electric service. Condensed combining financial information for the LLC has not been presented, as the effects of the LLC are not material to the Agency's financial statements taken as a whole. As of December 31, 2016, SMMPA Wisconsin, LLC's total assets were approximately $6.8 million, comprised principally of construction work in progress (CWIP).

(Continued)

(b) Basis of Accounting

The Agency follows the Federal Energy Regulatory Commission's Uniform System of Accounts and maintains accounting records on an accrual basis, in conformity with U.S. generally accepted accounting principles, as applicable to governmental entities, including the application of the Governmental Accounting Standards Board (GASB) Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, as the guidance relates to regulated operations. The guidance allows for deferral of revenues and expenses to future periods in which the revenues are earned or the expenses are recovered through the rate-making process.

(c) Capital Assets

Capital assets are recorded at cost, including interest capitalized on borrowed funds during construction.

The original cost of utility plant retired, plus removal costs, less salvage, is charged to accumulated depreciation. Depreciation is provided over the estimated useful life of the utility plant by use of the straight-line method. Depreciation is deferred to the extent that it exceeds current principal payments of the Agency's revenue bonds. This method correlates with the Agency's rate-making philosophy in that debt service requirements, as opposed to depreciation or amortization, are a cost for rate-making purposes.

(d) Deposits and Investments

Deposits and investments include cash, money market funds, and investments. Investments are reported at fair value based on quoted market prices.

(e) Restricted Investments

The Agency's bond resolution requires the segregation of bond proceeds and prescribes the application of the Agency's revenues. Amounts classified as restricted funds on the statements of net position represent investments whose use is restricted by the bond resolution. It is the Agency's policy to use restricted resources first for debt service, and then unrestricted resources as they are needed.

(f) Power Sales Revenue Receivables

Power sales revenue receivables, representing power sales to Members for the period between the last billing date and the end of the period, are accrued in the period sold.

(g) Fuel Stock and Material Inventory

Fuel stock is valued at average cost, which does not exceed market. Material inventory is valued at average cost, which does not exceed market.

(h) Compensated Absences

The Agency records a liability for vacation as the benefits accrue to employees. The Agency compensates all employees upon termination for unused vacation. Employees who have been employed by the Agency for at least five consecutive years who are leaving the Agency and who are eligible to retire as defined by the Public Employees Retirement Association (PERA), or the estate of

(Continued)

any such employee who dies while employed by the Agency, will receive a contribution to their retirement healthcare savings equal to one-third of the value of their remaining unused sick leave.

(i) Income Taxes

As a not for profit political subdivision of the State of Minnesota, the Agency is exempt from federal and state income taxes.

(j) Rates

The Agency designs its wholesale electric service rates to recover estimated costs of providing power supply services. In compliance with the power sales contract, rates and charges for providing wholesale power supply are reviewed annually by the Agency's board of directors. Any changes must be approved by the board of directors. In accordance with its senior bond resolution, the Agency shall establish rates that, together with other revenues, are reasonably expected to pay its operating costs (not including depreciation and amortization) and at least 1.10 times its aggregate debt service requirements. Power supply services provided by the Agency are not subject to state or federal rate regulation.

(k) Operating Revenues and Expenses

Operating revenues result from exchange transactions associated with the principal activity of the Agency, the sale of electricity. Reported operating revenues are affected by the contributions to, or distributions from, the rate stabilization account. Operating expenses are defined as expenses directly related to, or incurred in support of, the production and transmission of electricity to the participating Members. All other expenses are classified as nonoperating expenses.

(l) Deferred Costs to be Recovered in Future Periods

Costs in excess of the amounts currently billable to the Members are to be recovered from future revenues by setting rates sufficient to provide funds for the related debt service requirements. As allowed through the applications of the provisions of GASB Statement No. 62, current costs in excess of funding are deferred and shown as deferred costs to be recovered in future periods on the accompanying statement of net position and as expenses to be recovered in future periods on the statement of revenues, expenses, and changes in net position. These costs represent depreciation of electric plant and equipment, amortization of long-term debt issuance costs, and amortization of long-term debt discount/premium in excess of amounts currently billed to Members.

(m) Deferred Credits – Rate Stabilization

The Agency intends for its electric service rates to recover costs, as defined above, of providing power supply services. As part of its rate-making process, the Agency budgets an amount as a contribution to or a distribution from the rate stabilization account. The amount of the contribution to, or distribution from, the rate stabilization account is determined by the amount of revenues needed to meet the 1.10 coverage required by the senior bond resolution. Revenue associated with amounts designated as contributions to the rate stabilization account are deferred and reported as an addition to the deferred credits-rate stabilization account on the statements of net position. In the event actual operating expenses exceed the 1.10 coverage required by the senior bond resolution, the Agency has the ability to supplement its operating revenues, power sales, through the use of accumulations in its rate stabilization account. Usage of the rate stabilization results in the recognition of additional amounts of operating revenues, power sales, and a corresponding reduction in deferred credits-rate stabilization on the statements of net position. The Agency contributed (distributed) $6,119,827 and ($4,602,996) to (from) its rate stabilization account for the years ended December 31, 2016 and 2015, respectively.

(n) Deferred Gain on Involuntary Conversion of Plant Assets

In November 2011, the Agency experienced damage to its turbine and generator at Sherco 3. Pursuant to GASB Statement No. 62, the Agency established a regulatory liability, which represents the deferred gain resulting from the involuntary conversion of plant assets. The gain is being amortized by the Agency into income over the remaining life of Sherco 3 at the time of the incident.

(o) Cash Flows

For purposes of the statements of cash flows, the Agency does not consider investments in money market funds or other investments with original maturities of three months or less as cash equivalents.

(p) Use of Estimates

The preparation of financial statements in conformity with U.S. 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 these estimates.

(q) Recently Issued Accounting Standards

In May of 2015, GASB issued Statement No. 72, *Fair Value Measurement and Application*. This standard generally requires investments to be measured at fair value. The Agency adopted this statement in 2016, with retrospective application to 2015. The Statement requires disclosures to be made about fair value measurements, the level of fair value hierarchy, and valuation techniques.

(r) Deferred Outflows of Pension Resources

Deferred outflow of pension resources is reported only in the statement of net position. This item results from actuarial calculations and current year pension contributions made subsequent to the measurement date and represents a consumption of net position that applies to a future period(s) and so will not be recognized as an outflow of resources (expense/expenditure) until then.

(s) Pension Liability

For purposes of measuring the net pension liability, deferred outflows/inflows of resources, and pension expense, information about the fiduciary net position of the PERA and additions to/deductions from PERA's fiduciary net position have been determined on the same basis as they are reported by PERA except that PERA's fiscal year-end is June 30. For this purpose, plan contributions are recognized as of employer payroll paid dates and benefit payments and refunds are recognized when due and payable in accordance with the benefit terms. Investments are reported at fair value.

(t) Deferred Inflows of Pension Resources

Deferred inflows of pension resources, is reported only in the statement of net position and results from actuarial calculations. Deferred inflows of pension resources, represents an acquisition of net position

(Continued)

that applies to a future period(s) and so will not be recognized as an inflow of resources (revenue) until that time.

(u) Reclassifications

Certain 2015 comparative amounts have been reclassified to conform with the 2016 presentation.

(2) Deposits and Investments

The agency agreement that established the Agency and the bond resolution, under which the Power Supply System Revenue Bonds were issued, provides for the creation and maintenance of certain funds and accounts. The funds and accounts consist principally of deposits and investments in accordance with the agency agreement, bond resolution, and applicable state law. Funds and accounts are reported in the statement of net position as follows:

		2016	2015
Current assets:			
Cash	$	42,533	230,534
Investments:			
Unrestricted funds:			
Revenue and operating funds		31,083,103	29,854,848
Rate stabilization		65,955,166	65,122,923
Other		552,805	14,381,580
Total unrestricted funds		97,591,074	109,359,351
Restricted funds:			
Debt service account		66,304,797	61,884,010
Construction		5,847,453	15,524,092
Debt service reserve		249,432	248,532
Total restricted funds		72,401,682	77,656,634
Total current investments		170,035,289	187,246,519
Noncurrent investments:			
Restricted funds:			
Debt service reserve		74,116,710	74,371,800
Total noncurrent investments		74,116,710	74,371,800
Total	$	244,151,999	261,618,319

(a) Deposits

In accordance with applicable Minnesota Statutes, the Agency maintains deposits at depository banks authorized by the Agency's board of directors.

Minnesota Statutes require that all deposits be protected by federal deposit insurance, corporate surety bond, or collateral. The market value of collateral pledged must equal 110% of the deposits not covered by federal deposit insurance or corporate surety bonds.

Authorized collateral includes Treasury bills, notes, and bonds; issues of U.S. government agencies; general obligations rated "A" or better; revenue obligations rated "AA" or better; irrevocable standard letters of credit issued by the Federal Home Loan Bank; and certificates of deposit. Minnesota Statutes require that securities pledged as collateral be held in safekeeping in a restricted account at the Federal Reserve Bank or in an account at a trust department of a commercial bank or other financial institution that is not owned or controlled by the financial institution furnishing the collateral.

Deposit balances are as follows:

	2016	2015
Carrying amount of cash	$ 42,533	230,534
Bank balance	1,645,441	755,729

(b) Investments

Minnesota Statutes authorize the Agency to invest in the following types of investments:

- Direct obligations or obligations guaranteed by the United States of America or its agencies
- Shares of investment companies registered under the Federal Investment Company Act of 1940 whose only investments are securities described in (a) above
- General obligations of the State of Minnesota or any of its municipalities
- Bankers' acceptances of U.S. banks eligible for purchase by the Federal Reserve System
- Commercial paper issued by U.S. corporations or their Canadian subsidiaries, of the highest quality and maturing in 270 days or less
- Guaranteed investment contracts issued or guaranteed by U.S. commercial banks or domestic branches of foreign banks or U.S. insurance companies or their subsidiaries
- Repurchase or reverse repurchase agreements with banks that are members of the Federal Reserve System with capitalization exceeding $10,000,000, a primary reporting dealer in U.S. government securities to the Federal Reserve Bank of New York, or certain Minnesota securities broker-dealers
- Future contracts sold under authority of Minnesota Statutes 471.56, sub d.5.

The Agency's investments are potentially subject to various risks, including the following:

- Custodial credit risk – The risk that in the event of a failure of the counterparty to an investment transaction (typically a brokerage firm or financial institution), the Agency would not be able to recover the value of the investment or collateral securities. The Agency's investment policy does not limit the value of investments that may be held by an outside party.

- Credit risk – The risk that an issuer or other counterparty to an investment will not fulfill its obligations.
- Concentration of credit risk – The risk of loss attributed to the magnitude of the Agency's investment in a single issuer.
- Interest rate risk – The risk that changes in interest rates will adversely affect the fair value of an investment.

The Agency invests its funds under a board of directors approved internal investment policy that limits investment choices and addresses these potential risks beyond the statutory limitations described above. The Agency's policy requires that investments be diversified to avoid unreasonable risks inherent in overinvesting in specific instruments, individual financial institutions, or maturities. For U.S. government and federal agency securities, the Agency places no limit on the amount that may be invested in any one issuer. The maximum percentage in which the portfolio can be invested, in specific instruments, is as follows:

Investment Security	Total Portfolio Exposure	Exposure Per Issuer	Additional Restriction
U.S. Government Obligations	100%	Unlimited	None
Government Sponsored Enterprises	100%	Unlimited	Rated AA- or better by a nationally recognized bond rating agency.
Direct and General Obligations of any State of the United States	10%	$10,000,000	Rated AA- or better by a nationally recognized bond rating agency.
Bonds, Notes, Debentures or other evidence of indebtedness issued or guaranteed by any corporation	10%	$10,000,000	Rated AAA by a nationally recognized bond rating agency and rated AA- or better by at least one other nationally recognized bond rating agency.
Certificates of Deposit (negotiable or non-negotiable)	10%	$10,000,000	Exposure will be the lesser of $10,000,000 or 10% of the total of the capital, surplus and undivided earnings of such bank.

Investments are summarized as follows:

	2016		2015	
	Amortized cost	Fair value	Amortized cost	Fair value
Money market funds	$ 85,843,466	85,843,466	84,338,115	84,338,115
U.S. government securities	159,221,930	158,266,000	177,451,453	177,049,670
Total investments	$ 245,065,396	244,109,466	261,789,568	261,387,785

The following table presents the Agency's investment balances at December 31, 2016 and information relating to potential investment risks:

Investment	Interest rate risk: Less than 1 year	Interest rate risk: 1–5 years	Concentration risk: Over 5% of portfolio	Credit quality rating: S&P	Credit quality rating: Moody's	Carrying value
Government securities:						
Federal Home Loan Bank	$ —	20,834,980	8.5%	AA+	AAA	$ 20,834,980
Federal Farm Credit Bank	—	6,903,360	2.8%	AA+	AAA	6,903,360
Federal Home Loan Mortgage Corporation	—	11,898,440	4.9%	AA+	AAA	11,898,440
Federal National Mortgage Association	—	62,641,730	25.7%	AA+	AAA	62,641,730
Federal Home Loan Bank Discount Notes	9,996,080	—	4.1%	A-1+	P-1	9,996,080
United States Treasury Note	—	32,001,780	13.1%	AA+	AAA	32,001,780
United States Treasury Bill	13,989,630	—	5.7%	AA+	AAA	13,989,630
Cash management funds:						
Wells Fargo Advantage Treasury Plus Money Market	85,843,466	—	N/A	N/R	N/R	85,843,466
						$ 244,109,466

N/A Not applicable
N/R Not rated

The following table presents the Agency's investment balances at December 31, 2015 and information relating to potential investment risks:

Investment	Interest rate risk: Less than 1 year	Interest rate risk: 1–5 years	Concentration risk: Over 5% of portfolio	Credit quality rating: S&P	Credit quality rating: Moody's	Carrying value
Government securities:						
Federal Home Loan Bank	$ 4,990,200	14,899,730	7.6%	AA+	AAA	$ 19,889,930
Federal Farm Credit Bank	5,000,000	6,992,780	4.6%	AA+	AAA	11,992,780
Federal Home Loan Mortgage Corporation	14,993,470	16,962,130	12.2%	AA+	AAA	31,955,600
Federal National Mortgage Association	12,498,000	36,777,460	18.9%	AA+	AAA	49,275,460
Federal Home Loan Bank Discount Notes	17,993,040	—	6.9%	A-1+	P-1	17,993,040
United States Treasury Note	17,033,430	28,909,430	17.6%	AA+	AAA	45,942,860
Cash management funds:						
Wells Fargo Advantage Treasury Plus Money Market	84,338,115	—	N/A	N/R	N/R	84,338,115
						$ 261,387,785

N/A Not applicable
N/R Not rated

The foregoing investments are held by the Agency's counterparty, but not in the name of the Agency.

The Agency measures and records its investments using fair value measurement guidelines established by generally accepted accounting principles. These guidelines recognize a three-tiered fair value hierarchy, as follows:

- Level 1: Quoted prices for identical investments in active markets;
- Level 2: Observable inputs other than quoted market prices; and,
- Level 3: Unobservable inputs.

At December 31, 2016, the Agency had the following recurring fair value measurements.

Investments by fair value level	December 31, 2016	Fair value measurements using		
		Level 1	Level 2	Level 3
Government Securities:				
Federal Home Loan Bank	$ 20,834,980	—	20,834,980	—
Federal Farm Credit Bank	6,903,360	—	6,903,360	—
Federal Home Loan Mortgage Corporation	11,898,440	—	11,898,440	—
Federal National Mortgage Association	62,641,730	—	62,641,730	—
Federal Home Loan Discount Notes	9,996,080	—	9,996,080	—
United States Treasury Note	32,001,780	—	32,001,780	—
United States Treasury Bill	13,989,630	—	13,989,630	—
Total Government Securities	158,266,000	—	158,266,000	—
Cash Management Funds:				
Wells Fargo Advantage Treasury Plus Money Market	85,843,466	85,843,466	—	—
Total investments by fair value level	$ 244,109,466	85,843,466	158,266,000	—

Investments by fair value level	December 31, 2015	Fair value measurements using		
		Level 1	Level 2	Level 3
Government Securities:				
Federal Home Loan Bank	$ 19,889,930	—	19,889,930	—
Federal Farm Credit Bank	11,992,780	—	11,992,780	—
Federal Home Loan Mortgage Corporation	31,955,600	—	31,955,600	—
Federal National Mortgage Association	49,275,460	—	49,275,460	—
Federal Home Loan Discount Notes	17,993,040	—	17,993,040	—
United States Treasury Note	45,942,860	—	45,942,860	—
Total Government Securities	177,049,670	—	177,049,670	—
Cash Management Funds:				
Wells Fargo Advantage Treasury Plus Money Market	84,338,115	84,338,115	—	—
Total investments by fair value level	$ 261,387,785	84,338,115	177,049,670	—

Government securities and cash management funds classified in Level 1 are valued using prices quoted in active markets for those securities. Government securities classified in Level 2 are valued using the following approaches:

- U.S. Treasuries, U.S. Agencies. and Commercial Paper quoted prices for identical securities in markets that are not active.
- Corporate and Municipal Bonds: quoted prices for similar securities in active markets;
- Repurchase Agreements, Negotiable Certificates of Deposit, and Collateralized Debt Obligations: matrix pricing based on the securities' relationship to benchmark quoted prices;
- Money Market, Bond, and Equity Mutual Funds: published fair value per share (unit) for each fund.

(3) Capital Assets

Capital asset activity was as follows:

2016	Beginning balance	Additions	Transfers	Retirements	Ending balance
Nondepreciable:					
Land and land rights	$ 6,304,758	—	—	—	6,304,758
Construction work in progress	53,426,177	35,553,891	(38,727,472)	—	50,252,596
Depreciable:					
Utility plant in service	781,455,109	—	38,727,472	(2,190,164)	817,992,417
Less accumulated depreciation for utility plant in service	(352,472,311)	(21,414,661)	—	2,190,164	(371,696,808)
Capital assets, net	$ 488,713,733	14,139,230	—	—	502,852,963

2015	Beginning balance	Additions	Transfers	Retirements	Ending balance
Nondepreciable:					
Land and land rights	$ 6,304,758	—	—	—	6,304,758
Construction work in progress	52,784,314	31,673,947	(31,032,084)	—	53,426,177
Depreciable:					
Utility plant in service	755,013,158	11,835,974	31,032,084	(16,426,107)	781,455,109
Less accumulated depreciation for utility plant in service	(336,406,698)	(19,905,679)	—	3,840,066	(352,472,311)
Capital assets, net	$ 477,695,532	23,604,242	—	(12,586,041)	488,713,733

(Continued)

(4) Long-Term Debt

The Agency has issued the following Power Supply System Revenue Bonds to finance portions of its construction activities:

		2016	2015
Series 2002A, 2.00% – 5.25%, due January 1, 2004 to 2018	$	50,165,000	97,525,000
Series 2006A, 3.65% – 4.25%, due January 1, 2011 to 2027		10,060,000	14,290,000
Series 2009A, 2.00% – 5.50%, due January 1, 2011 to 2030		10,495,000	12,845,000
Taxable Series 2010A (Build America Bonds), 3.774%–5.926%, due January 1, 2018 to 2043		67,990,000	67,990,000
Series 2010B (Tax-Exempt), 2.00%–4.00%, due January 1, 2013 to 2017		1,640,000	3,230,000
Series 2015A, 2.00%–5.0%, due January 1, 2016 to 2046		97,675,000	97,840,000
		238,025,000	293,720,000
Less unamortized discount/premium		(17,088,778)	(20,829,810)
		255,113,778	314,549,810
Series 1994A, 6.65%–6.70%, CABs due January 1, 2019 to 2027		503,300,000	503,300,000
Series 2002A, 4.65% CABs, due January 1, 2018		55,320,000	55,320,000
		558,620,000	558,620,000
Less unamortized discount		158,376,720	182,843,509
		400,243,280	375,776,491
		655,357,058	690,326,301
Less current maturities		60,090,000	55,695,000
	$	595,267,058	634,631,301

Power Supply System Revenue Bonds are the major source of financing for the Agency's construction activities. These are secured by all funds and revenues of the Agency derived from the ownership and operation of its power supply system.

Long-term debt issuance costs attributable to refunded bonds, long-term debt issuance costs, and the discount/premium on long-term debt are amortized over the terms of the related bond issues under the effective-interest method.

During 2015, the Agency issued $97,840,000 in tax-exempt Power Supply Revenue Bonds, Series 2015 A at par value. An additional premium of $15,207,102, and other sources of funds, resulted in total sources of funds for the issuance of $113,669,340. A portion of the proceeds was used for payment of $33,000,000 of the Agency's Commercial Paper Notes, Series B. Proceeds of $56,671,366 were deposited in an irrevocable trust with an escrow agent to provide for all future debt service payments for refunding callable Series 2006 A revenue bonds in the amount of $13,510,000, and Series 2009 A revenue bonds in the amount of $36,905,000. The remainder of the proceeds will fund the completion of the CapX 2020 transmission project.

The advance refunding resulted in a difference between the requisition price of the Series 2006 A and 2009 A bonds, and the net carrying amount of the reacquired bonds of $5,185,309. This difference, reported in the accompanying financial statements as a component of deferred outflows – advance refunding of debt, is being charged to operations through the year 2029 using the straight-line method. The Agency completed the advance refunding to reduce its total debt service payments over the next 15 years by $4,811,031 and to obtain an economic gain present value savings of $3,951,725.

Revenue bond debt service requirements to maturity are as follows:

		Principal	Interest
2017	$	60,090,000	11,922,779
2018		63,795,000	8,903,488
2019		65,050,000	8,565,814
2020		65,210,000	8,282,073
2021		65,425,000	7,986,589
2022–2026		331,795,000	34,830,404
2027–2031		72,935,000	24,839,757
2032–2036		22,690,000	17,453,252
2037–2041		27,990,000	10,582,161
2042–2047		21,665,000	2,843,814
	$	796,645,000	136,210,131

Long-term liability activity for the year ended December 31, 2016 was as follows:

2016		Beginning balance	Additions	Reductions	Ending balance
Long-term revenue bonds	$	852,340,000	—	(55,695,000)	796,645,000
Less:					
Current maturities		(55,695,000)	(4,395,000)	—	(60,090,000)
Unamortized discount, net		(162,013,699)	—	20,725,757	(141,287,942)
Long-term revenue bonds, net	$	634,631,301	(4,395,000)	(34,969,243)	595,267,058
Derivative instruments – swap liability	$	608,287	—	(425,807)	182,480
Pension liability		4,384,411	2,135,551	—	6,519,962

(Continued)

Long-term liability activity for the year ended December 31, 2015 was as follows:

2015		Beginning balance	Additions	Reductions	Ending balance
Long-term revenue bonds	$	856,850,000	97,840,000	(102,350,000)	852,340,000
Less:					
Current maturities		(51,935,000)	(3,760,000)	—	(55,695,000)
Unamortized discount, net		(212,483,277)	—	50,469,578	(162,013,699)
Long-term revenue bonds, net	$	592,431,723	94,080,000	(51,880,422)	634,631,301
Derivative instruments – swap liability	$	749,177	—	(140,890)	608,287
Pension liability		4,817,582	—	(433,171)	4,384,411

(5) Notes Payable

Since 1995, the Agency is authorized to borrow and reborrow from time to time up to $68,000,000 outstanding at any one time, evidenced by the issuance of Commercial Paper Notes, Series B. The Commercial Paper Notes, Series B bear interest payable at maturity at a maximum rate not in excess of 15% per annum, and shall mature not more than 270 days after issuance. The interest rate on the $35,000,000 outstanding at December 31, 2016 was between 0.65% and 0.74%.

Commercial Paper Notes, Series B activity for the years ended December 31, 2016 and 2015 was as follows:

Activity for fiscal year		Beginning balance	Issues	Maturities	Ending balance
2016	$	35,000,000	526,700,000	(526,700,000)	35,000,000
2015		45,000,000	364,000,000	(374,000,000)	35,000,000

The Agency entered into a Continuing Covenants Agreement (CCA), Southern Minnesota Municipal Power Agency Badger Coulee Project Revenue Bonds, 2016 Series A, with U.S. Bank on May 25, 2016. The CCA allows U.S. Bank to provide short term construction financing for the Badger Coulee transmission project up to $35,000,000 with a 3 year term with an option to extend the agreement. The financing is in the form of a loan made by U.S. Bank as a condition of the Agency issuing variable rate bonds, which are then purchased directly by the bank. The Notes shall bear interest at a per annum rate of interest equal to the sum of (i) the Bank Index times an Applicable Factor and (ii) the Applicable Spread (the *"Index Rate"),* subject to adjustment, along with a fee on the unused portion of the program. The Bank Index shall be one-month LIBOR, which shall be reset on the first day of each calendar month based upon LIBOR two New York Business Days prior to each such rate date. The Notes shall bear interest at the Index Rate so long as no Event of Taxability or Event of Default has occurred.

Badger Coulee Project Revenue Bonds, 2016 Series A activity for the year ended December 31, 2016 was as follows:

Activity for fiscal year	Beginning balance	Issues	Maturities	Ending balance
2016	$ —	5,000,000	—	5,000,000

(6) Derivative Instruments

The Agency applies GASB Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*. The tables below summarize derivative instrument activity for the years ended December 31, 2016 and 2015 and balances at end of 2016 and 2015:

	Changes in fair value for year ended December 31, 2016		Fair value at December 31, 2016		Notional
	Classification	Amount	Classification	Amount	amount
Cash flow hedges:					
Pay-fixed interest rate swaps	Deferred outflow	$ (425,807)	Long-term liabilities	$ (182,480)	10,060,000

	Changes in fair value for year ended December 31, 2015		Fair value at December 31, 2015		Notional
	Classification	Amount	Classification	Amount	amount
Cash flow hedges:					
Pay-fixed interest rate swaps	Deferred outflow	$ (140,890)	Long-term liabilities	$ (608,287)	14,290,000

The fair values of the interest rate swaps were estimated using the zero-coupon method. This method calculates the future net settlement payments required by the swap, assuming that the current forward rates implied by the yield curve correctly anticipate future spot interest rates. These payments are then discounted using the spot rates implied by the current yield curve for hypothetical zero-coupon bonds due on the date of each future net settlement on the swaps.

(a) Objectives

In order to better manage its interest rate exposure and to reduce the overall costs of its financings, the Agency entered into five separate pay-fixed, receive-variable interest rate swaps.

(b) Terms

Certain key terms relating to the outstanding hedging derivative instruments are presented below:

Associated financing issue		Notional amounts	Effective date	Fixed rate paid	Rate received	Swap termination date	Final maturity of bonds
Hedging derivatives:							
Cash flow hedges, pay-fixed interest rate swaps:							
Series 2006A		5,030,000	9/6/2006	3.93	CPI Rate (1) + 0.71%	1/1/2017	1/1/2017
Series 2006A		3,395,000	9/6/2006	3.98	CPI Rate (1) + 0.76%	1/1/2018	1/1/2018
Series 2006A		1,635,000	9/6/2006	4.02	CPI Rate (1) + 0.79%	1/1/2019	1/1/2019
Total	$	10,060,000					

(1) CPI rate is defined by the swaps' letter agreement and is generally defined as the percentage change in the CPI index over a rolling 12-month period computed every six months beginning with the semiannual calculation on January 1, 2007 using the October 2006 and 2005 CPI indices.

(c) Credit Risk

Credit risk can be measured by actual market value exposure or theoretical exposure. When the fair value of any swap has a positive market value, then the Agency is exposed to the actual risk that the counterparty will not fulfill its obligations. As of December 31, 2016, the Agency had no net exposure to actual credit risk on its hedging derivatives because each had a negative fair value.

(d) Interest Rate Risk

All hedging derivatives are pay-fixed, receive-variable, cash flow hedges hedging a portion of the Agency's variable-rate debt. The Agency believes it has significantly reduced interest rate risk attributable to the principal amount being hedged by entering into these pay-fixed, receive-variable interest rate swaps.

(e) Basis Risk

The Agency is exposed to basis risk when the variable interest received on a swap is based on a different index than the variable interest rate to be paid on the associated variable rate debt obligation. As of December 31, 2016, the associated debt used the same index for all Consumer Price Index (CPI) referenced swaps. As a result, there is no significant exposure to basis risk as of December 31, 2016.

(f) Termination Risk

The Agency or counterparty may terminate any of the swaps if the other party fails to perform under the terms of the contract. In such cases, the Agency may owe or be due a termination payment depending on the fair value of the swap at that time. The termination payment due to a counterparty may not be equal to the fair value. If any of the swaps were terminated, the associated variable rate financings would no longer carry synthetic interest rates.

(g) Rollover Risk

The Agency is exposed to rollover risk on swaps that mature or may be terminated prior to the maturity of the associated financings. When these swaps terminate, or in the case of the termination option, if the counterparty exercises its option, the Agency will not realize the synthetic rate offered by the swaps on the underlying issues. The Agency is exposed to rollover risk on its swaps should they be terminated prior to the maturity of the associated financings.

(h) Foreign Currency Risk

All derivatives are denominated in U.S. dollars, and therefore, the Agency is not exposed to foreign currency risk.

(7) Pension Plan

(a) Plan Description

All full-time and certain part-time employees of the Agency are covered by a defined benefit plan administered by PERA. PERA administers the General Employees Retirement Fund (GERF), which is a cost-sharing, multiple-employer retirement plan. This plan is established and administered in accordance with Minnesota Statutes, Chapters 353 and 356. PERA's defined benefit pension plans are tax qualified plans under Section 401(a) of the Internal Revenue Code.

GERF members belong to either the Coordinated Plan or the Basic Plan. Coordinated Plan members are covered by Social Security, and Basic Plan members are not. The Basic Plan was closed to new members in 1967. All new members must participate in the Coordinated Plan.

PERA provides retirement benefits, as well as disability benefits, to members, and benefits to survivors upon death of eligible members. Benefits are established by state statute, can only be modified by the state legislature, and are vested after three years of credited service. The defined retirement benefits are based on a member's highest average salary for any five successive years of allowable service, age, and years of credit at termination of service.

Two methods are used to compute benefits for PERA's Coordinated and Basic Plan members. The retiring member receives the higher of a step-rate benefit accrual formula (Method 1) or a level accrual formula (Method 2). Under Method 1, the annuity accrual rate for a Basic Plan member is 2.2% of average salary for each of the first ten years of service and 2.7% for each remaining year. The annuity accrual rate for a Coordinated Plan member is 1.2% of average salary for each of the first ten years and 1.7% for each remaining year. Under Method 2, the annuity accrual rate is 2.7% of average salary for Basic Plan members and 1.7% for Coordinated Plan members for each year of service. For members hired prior to July 1, 1989, a full annuity is available when age plus years of service equal 90 and normal retirement age is 65. For members hired on or after July 1, 1989, normal retirement age is the age for unreduced Social Security benefits capped at 66.

There are different types of annuities available to members upon retirement. A single-life annuity is a lifetime annuity that ceases upon the death of the retiree for which no survivor annuity is payable. There are also various types of joint and survivor annuity options available which will be payable over joint lives. Members may also leave their contributions in the fund upon termination of public service in order to qualify for a deferred annuity at retirement age. Refunds of contributions are available at any time to members who leave public service, but before retirement benefits begin.

Benefit increases are provided to benefit recipients each January. Increases are related to the funding ratio of the plan. Members in plans that are at least 90% funded for two consecutive years are given 2.5% increases. Members in plans that have not exceeded 90% funded, or have fallen below 80%, are given 1% increases.

The benefit provisions stated in the previous paragraphs of this section are current provisions and apply to active plan participants. Vested, terminated employees who are entitled to benefits but are not receiving them yet are bound by the provisions in effect at the time they last terminated their public service.

(b) Funding Policy

Minnesota Statutes Chapter 353 sets the rates for employer and employee contributions. Contribution rates can only be modified by the state legislature. The Agency makes annual contributions to the pension plans equal to the amount required by Chapter 353 of the state statutes. In 2016, the Agency was required to contribute the following percentages of annual covered payroll: 11.78% for Basic Plan members and 7.50% for Coordinated Plan members. The Agency’s contributions to GERF for the years ended December 31, 2016 and 2015 were $379,596 and $373,537, respectively. The Agency’s contributions were equal to the contractually required contributions for both years as set by the statute. The Agency’s employees are all Coordinated Plan members.

(c) Pension Costs

The Agency reported a liability of $6,519,962 and $4,384,411 at December 31, 2016 and 2015, respectively, for its proportionate share of the GERF’s net pension liability. The net pension liability was measured as of June 30 for each respective year, and the total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of that date. The Agency’s proportion of the net pension liability was based on the Agency’s contributions received by PERA during the measurement period for employer payroll paid dates from July 1 through June 30 for each respective year relative to the total employer contributions received from all of PERA’s participating employers. At June 30, 2016, the Agency’s proportionate share was 0.0803%, which was a decrease of 0.0043% from its proportion measured as of June 30, 2015 of 0.0846%.

For the years ended December 31, 2016 and 2015, the Agency recognized pension expense of $466,345 and $495,179, respectively, for its proportionate share of GERF’s pension expense.

At December 31, 2016, the Agency reported its proportionate share of GERF's deferred outflows of resources and deferred inflows of resources, and its contributions subsequent to the measurement date, from the following sources:

		Deferred outflows of resources	Deferred inflows of resources
Differences between expected and actual economic experience	$	22,157	537,141
Changes in actuarial assumptions		1,411,311	—
Net difference between projected and actual earnings on plan investments		1,253,339	536,896
Change in proportion		—	372,736
Contributions to GERF subsequent to the measurement date		374,731	
Total	$	3,061,538	1,446,773

Deferred outflows of resources related to pensions resulting from the Agency's contributions subsequent to the measurement date in the amount of $374,731 were reported and will be recognized as a reduction of the net pension liability in the year ending December 31, 2016. Other amounts reported as deferred outflows and inflows of resources related to pensions will be recognized in pension expense as follows:

2017	$	(291,098)
2018		(134,248)
2019		(579,177)
2020		(235,511)
Thereafter		
	$	(1,240,034)

(d) Actuarial Assumptions

The total pension liability in the June 30, 2016 and 2015 actuarial valuations were determined using the following actuarial assumptions:

	2016	2015
Inflation	2.50% per year	2.75% per year
Active member payroll growth	3.25% per year	3.50% per year
Investment rate of return	7.50%	7.90%

Salary increases were based on a service-related table. Mortality rates for active members, retirees, survivors, and disabled participants were based on RP 2014 tables for males or females, as appropriate, with slight adjustments. Cost-of-living benefit increases for retirees are assumed to be 1% effective every January 1st until 2035, then 2.5% for the GERF participants.

Actuarial assumptions used in the June 30, 2016 valuation were based on the results of actuarial experience studies. The most recent four-year experience study in the General Employees Plan was completed in 2015. The following changes in actuarial assumptions occurred in 2016:

General Employees Fund

- The assumed post-retirement benefit increase rate was changed from 1.0% per year through 2035 and 2.5% per year thereafter to 1.0% per year for all future years.
- The assumed investment return was changed from 7.9% to 7.5%. The single discount rate was changed from 7.9% to 7.5%.
- Other assumptions were changed pursuant to the experience study dated June 30, 2015. The assumed future salary increases, payroll growth, and inflation were decreased by 0.25% to 3.25% for payroll growth and 2.50% for inflation.

The long-term expected rate of return on pension plan investments is 7.5%. The State Board of Investment, which manages the investments of PERA, prepares an analysis of the reasonableness of the long-term expected rate of return on a regular basis using a building-block method in which best-estimate ranges of expected future rates of return are developed for each major asset class. These ranges are combined to produce an expected long-term rate of return by weighting the expected future rates of return by the target asset allocation percentages. The target allocation and best estimates of arithmetic real rates of return for each major asset class are summarized in the following table:

	Target allocation	Expected real rate of return
Asset class:		
Domestic stocks	45.00%	5.50%
International stocks	15.00%	6.00%
Bonds	18.00%	1.45%
Alternative assets	20.00%	6.40%
Cash	2.00%	0.50%
Total	100.00%	

(e) Discount Rate

The discount rate used to measure the total pension liability was 7.5% in 2016 and 7.95% in 2015. The projection of cash flows used to determine the discount rate assumed that employee and employer contributions will be made at the rate specified in statute. Based on that assumption, each of the pension plan's fiduciary net position was projected to be available to make all projected future benefit payments of current active and inactive employees. Therefore, the long-term expected rate of return on

(Continued)

pension plan investments was applied to all periods of projected benefit payments to determine the total pension liability.

(f) Pension Liability Sensitivity

The following presents the Agency's proportionate share of the net pension liability for all plans it participates in, calculated using the discount rate disclosed in the preceding paragraph, as well as what the Agency's proportionate share of the net pension liability would be if it were calculated using a discount rate one percentage point lower or one percentage point higher than the current discount rate:

		Proportionate share of NPL		
		1% decrease (6.50%)	Current (7.50%)	1% increase (8.50%)
GERF	$	9,260,278	6,519,962	4,262,687

(g) Pension Plan Fiduciary Net Position

Detailed information about GERF's fiduciary net position is available in a separately issued PERA financial report that includes financial statements and required supplementary information. That report may be obtained on the Internet at www.mnpera.org; by writing to PERA at 60 Empire Drive #200, St. Paul, MN, 55103-2088; or by calling 651 296-7460 or 800 652-9026.

(8) Deferred Compensation Plans

The Agency offers its employees a deferred compensation plan created in accordance with Internal Revenue Code Section 457. The plan, available to all Agency employees, permits them to defer a portion of their salary until future years. The deferred compensation is not available to employees until termination, retirement, death, or unforeseeable emergency. All assets and income of the plan are held in a trust established for the exclusive benefit of eligible employees and their beneficiaries in accordance with Internal Revenue Code Section 457(g). Participants' rights under the plan are equal to the fair market value of the deferred account for each participant. The trust shall not revert to the Agency or be used for or diverted to purposes other than the exclusive benefit of participants and their beneficiaries. The plan is managed by third-party administrators. Plan assets were $12,577,428 and $11,355,066 at December 31, 2016 and 2015, respectively. The Agency contributed $99,793 and $115,269 to the plan for the years ended December 31, 2016 and 2015, respectively.

The Agency also offers a tax qualified defined contribution plan created in accordance with Internal Revenue Code Section 401(a). The plan, available to all Agency employees with six months of continuous service, permits them to defer a portion of their salary until future years. The amount deferred is not available to employees until termination, retirement, death, or unforeseeable emergency. Participants' rights under the plan are equal to the fair market value of the account for each participant. The plan is managed by third-party administrators. Plan assets were $2,189,760 and $1,705,813 at December 31, 2016 and 2015, respectively. The Agency contributed $221,654 and $239,170 to the plan for the years ended December 31, 2016 and 2015, respectively.

(Continued)

(9) Risk Management

The Agency is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees and others; and natural disasters. Cash and investments held in the Agency's unrestricted funds are available to cover uninsured losses.

The Agency continues to carry commercial insurance for other risks of loss including boiler and machinery, workers' compensation, property, general and excess liability, cyber liability, and employee health and accident. Settled claims resulting from these risks have not exceeded commercial insurance coverage in any of the past three fiscal years.

(10) Contingencies

The Agency purchases coal for its jointly owned Sherco Unit 3 from Western Fuels Association, a not-for profit cooperative that supplies coal and transportation services to consumer-owned electric utilities (Western Fuels). Western Fuels contracts with Absaloka Coal, LLC, a wholly owned subsidiary of Westmoreland Coal Company (Westmoreland) for deliveries of coal from its Absaloka coal mine to Sherco 3. Following the catastrophic failure of the Sherco 3 turbine and generator in November 2011, Western Fuels invoked the force majeure clause of its contract with Westmoreland and halted deliveries of coal while the unit was undergoing restoration. In November 2014, the Agency was provided with a notice of a demand for arbitration and related pleadings seeking to pursue a claim for monetary damages against the Agency, Western Fuels, and Northern States Power Company d/b/a Xcel Energy (Xcel), the co-owner of Sherco 3. The demand was made by certain insurance companies as subrogees for Westmoreland. The Westmoreland insurers claim that they incurred significant damages because of payments made to Westmoreland under a business interruption insurance policy when purchases of coal were interrupted.

Because the Westmoreland insurers have only made an aggregate claim for damages against Xcel, Western Fuels, and the Agency, it is not possible to determine the amount of the claim, or the portion of damages, for which the Agency might be claimed to be liable. The Agency has significant procedural, substantive, and contractual defenses to the Westmoreland claims, and intends to defend the demand for arbitration vigorously. Because the potential liability cannot be reasonably estimated and because management of the Agency believes that the probability of a material adverse judgment against the Agency is remote, no liability has been reflected in the Agency's financial statements for this matter.

The Agency recently resolved an ongoing dispute with a participant in the CapX Hampton to La Crosse transmission facilities project regarding cost recovery and MISO pricing zone matters. However, certain related disputes are pending that could affect the allocation and cost recovery of certain CapX facilities in a manner adverse to the Agency. It is not presently expected that the outcome of these disputes, when resolved, will have a material adverse impact on the financial position of the Agency.

SOUTHERN MINNESOTA MUNICIPAL POWER AGENCY

Required Supplementary Information (Unaudited)

December 31, 2016

Schedule of Agency's Proportionate Share of Net Pension Liability and Related Ratios as of Measurement Date
PERA General Employees Retirement Fund
Cost-Sharing Multiple-Employer Defined Benefit Pension Plans (Last Ten Fiscal Years*)

Fiscal year ending (for the measurement period)	Employer's proportion (percentage) of the net pension liability (asset)	Employer's proportionate share (amount) of the net pension liability (asset) (a)	Employer's covered-employee payroll (b)	Employer's proportionate share of the net pension liability (asset) as a percentage of its covered-employee payroll (a/b)	Plan Fiduciary net position as a percentage of the total pension liability
June 30, 2015	0.0846%	$ 4,384,411	4,980,497	88.03%	78.19%
June 30, 2016	0.0803%	6,519,962	5,061,274	128.82%	68.91%

* Fiscal year 2015 was the first year of implementation; therefore, only two years are shown. The amounts presented were determined using a measurement date of June 30.

SOUTHERN MINNESOTA MUNICIPAL POWER AGENCY

Required Supplementary Information (Unaudited)

December 31, 2016

Schedule of Agency's Contributions
PERA General Employees Retirement Fund
Cost-Sharing Multiple-Employer Defined Benefit Pension Plans (Last Ten Fiscal Years*)

Fiscal year ending (for the financial reporting period)		Statutorily required contribution (a)	Contributions in relation to the statutorily required contribution (b)	Contribution deficiency (excess) (a-b)	Covered-employee payroll (d)	Contributions as a percentage of covered-employee payroll (b/d)
December 31, 2015	$	373,537	373,537	—	4,980,497	7.50%
December 31, 2016		379,596	379,596	—	5,061,274	7.50%

* Fiscal year 2015 was the first year of implementation. Additional years information will be included as it becomes available in future years.