

**NORTHERN MUNICIPAL POWER AGENCY
THIEF RIVER FALLS, MINNESOTA**

AUDITED FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2016 AND 2015

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**NORTHERN MUNICIPAL POWER AGENCY
ROSTER OF BOARD OFFICIALS
FOR THE YEAR ENDED DECEMBER 31, 2016**

Participants

Bagley, Minnesota
Baudette, Minnesota
Fosston, Minnesota
Grafton, North Dakota
Halstad, Minnesota
Hawley, Minnesota
Park River, North Dakota
Roseau, Minnesota
Stephen, Minnesota
Thief River Falls, Minnesota
Warren, Minnesota
Warroad, Minnesota

Representatives

Mike Jensen
Roger Schotl
David Larson
Chris West
Lucas Spaeth
Jerald Pederson
Dennis Larson
Todd Peterson
Leonard Bazey
Dale Narlock
Shannon Mortenson
Ron Kleinschmidt

President
Vice-President
Secretary-Treasurer
General Manager

Jerald Pederson
Lucas Spaeth
Dalene Monsebroten
Darryl Tveitbakk



CERTIFIED PUBLIC ACCOUNTANTS
AND CONSULTANTS

INDEPENDENT AUDITOR'S REPORT

To the Board of Directors
Northern Municipal Power Agency
Thief River Falls, Minnesota

Report on the Financial Statements

We have audited the accompanying financial statements of Northern Municipal Power Agency, which comprise the statements of net position as of December 31, 2016 and 2015, and the related statements of revenues and costs, and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express an opinion on these 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 includes performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's 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 net position of Northern Municipal Power Agency as of December 31, 2016 and 2015, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis, schedule of Agency's contributions to the MN PERA retirement plan, and schedule of Agency's share of the net pension liability as listed in the table of contents 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.



**BRADY, MARTZ & ASSOCIATES, P.C.
GRAND FORKS, NORTH DAKOTA**

February 27, 2017

NORTHERN MUNICIPAL POWER AGENCY
MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE YEARS ENDED DECEMBER 31, 2016 AND 2015

FINANCIAL STATEMENT OVERVIEW

This discussion and analysis of Northern Municipal Power Agency's (Northern) financial performance provides an overview of Northern'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 accounting principles generally accepted in the United States of America. Northern's basic financial statements include the statements of net position, the statements of revenues and costs, and the statements of cash flows.

The statements of net position provide information about the nature and amount of assets and obligations (liabilities) of Northern as of the end of the year. The statements of revenues and costs report revenues and expenses for the current year. The statements of cash flows report cash receipts, cash payments, and net changes in cash resulting from operating, capital and related financing activities, and investing activities.

FINANCIAL HIGHLIGHTS

The following table summarizes the financial position of Northern as of December 31:

Condensed Statements of Net Position

	2016	2015	2014	2016 vs 2015	
				Dollar Change	Percent Change
Net Utility Plant	\$ 130,623,045	\$ 144,158,888	\$ 160,521,964	\$ (13,535,843)	(9.4)
Current Assets	62,238,319	74,443,255	80,335,696	(12,204,936)	(16.4)
Total Assets	192,861,364	218,602,143	240,857,660	(25,740,779)	(11.8)
Deferred Outflows of Resources	118,585	22,466	-	96,119	100.0
Current Liabilities	32,148,541	30,490,282	32,112,660	1,658,259	5.4
Long-term Liabilities	160,802,944	188,115,658	208,745,000	(27,312,714)	(14.5)
Total Liabilities	192,951,485	218,605,940	240,857,660	(25,654,455)	(11.7)
Deferred Inflows of Resources	28,464	18,669	-	9,795	100.0
Net Investment in Capital Assets	(54,061,955)	(64,586,112)	(69,238,036)	10,524,157	16.3
Restricted by Bond Agreements	49,197,237	60,095,964	64,307,988	(10,898,727)	(18.1)
Unrestricted	4,864,718	4,490,148	4,930,048	374,570	8.3
Total Net Position	\$ -	\$ -	\$ -	\$ -	-

NORTHERN MUNICIPAL POWER AGENCY
MANAGEMENT'S DISCUSSION AND ANALYSIS - CONTINUED
FOR THE YEARS ENDED DECEMBER 31, 2016 AND 2015

Condensed statements of net position highlights are as follows:

- Net utility plant decreased by approximately \$13.6 million. Net utility plant includes Northern's 30% share of the Coyote generating station and Northern's approximate load-ratio share of the related transmission system. The \$13.6 million decrease in net utility plant is mainly due to an additional year's depreciation offset by property additions.
- Current assets decreased by approximately \$12.2 million. Current assets include cash, investments and accounts receivable. The decrease is primarily related to the use of construction funds to finance Coyote plant and transmission property additions.
- Current liabilities increased by approximately \$1.7 million primarily due to an increase in the current maturities of revenue bonds.
- Revenue bonds, net of current maturities, decreased by approximately \$27.4 million. The decrease is due to the refunding of bonds in May 2016 as well as scheduled bond principal payments made in 2016.
- The net pension liability, deferred outflows of resources, and deferred inflows of resources were due to the implementation of GASB 68, which required the Agency to record its share of the PERA net pension liability.

The following table summarizes the changes in financial position of Northern for the years ended December 31, 2016, 2015 and 2014:

Condensed Statements of Revenues and Costs

	2016	2015	2014	2016 vs 2015	
				Dollar Change	Percent Change
Revenues	\$ 66,780,186	\$ 54,746,684	\$ 57,777,997	\$ 12,033,502	22.0
Operating Costs	\$ 57,471,289	\$ 44,343,163	\$ 46,285,212	\$ 13,128,126	29.6
Interest	9,308,897	10,403,521	11,492,785	(1,094,624)	(10.5)
Total Costs	\$ 66,780,186	\$ 54,746,684	\$ 57,777,997	\$ 12,033,502	22.0

Condensed statements of revenues and costs highlights are as follows:

- Total revenues increased by \$12.0 million. Revenues from Exempt Sales to Public Authorities and Other Income increased by \$8.0 million. Revenues from Participants increased by \$0.6 million and Revenues from Minnkota Power Cooperative, Inc. (Minnkota) increased by \$3.4 million. Revenues from Exempt Sales to Public Authorities and Other Income increased primarily due to higher surplus sales from the Coyote Plant. The increase in Revenues from Participants is due to a 3.3% rate increase on April 1, 2016 offset by a 1.8% decrease in energy kWh sales. Revenues from Minnkota were up primarily due to there being more Coyote plant costs in 2016 for Minnkota to cover under the Power Supply Coordination Agreement. Per this Agreement, Minnkota purchases all capacity and energy in excess of Northern's requirements at a cost to satisfy Northern's revenue requirements, subject to limitations pursuant to Federal tax law.

NORTHERN MUNICIPAL POWER AGENCY
MANAGEMENT'S DISCUSSION AND ANALYSIS - CONTINUED
FOR THE YEARS ENDED DECEMBER 31, 2016 AND 2015

- Total operating costs increased by \$13.1 million. Total operating costs include fuel and operating & maintenance expenses for Northern's 30% share of the Coyote generating plant, transmission operating expenses, administrative expenses, and depreciation. Depreciation is provided for on a sinking fund method with depreciation equivalent to the principal payments required to pay the outstanding bonds. Depreciation expense increased \$3.4 million due to higher bond principal payments. Operation and maintenance expense increased by \$5.8 million and fuel increased by \$4.0 million mainly due to the Coyote plant operating at full load compared to a reduced load for most of the prior year due to boiler feed pump issues.

- Interest expense decreased by \$1.1 million in 2016.

DEBT ADMINISTRATION

As of December 31, 2016, Northern had debt outstanding of approximately \$184.7 million, a decrease of approximately \$24.1 million from December 31, 2015. Northern made scheduled bond principal payments of \$20.8 million on January 4, 2016. Refunding of 2007A Bonds was done in May 2016 which resulted in a net decrease in bonds payable of \$3.3 million. Northern bonds have an "A-" rating from Standard & Poor's and an "A3" rating from Moody's.

FACTORS BEARING ON NORTHERN'S FUTURE

Northern is subject to various federal, state and local laws, rules and regulations relating to air and water quality, hazardous and solid waste disposal, reporting of toxic releases and air emissions, and other environmental matters. These laws, rules and regulations often require Northern to undertake considerable efforts and substantial costs to obtain licenses, permits and approvals from various federal, state and local agencies. Northern cannot predict at this time whether any additional legislation or rules will be enacted which will affect its operations, and if such laws or rules are enacted, what the future cost to Northern might be because of such action.

NORTHERN MUNICIPAL POWER AGENCY
STATEMENTS OF NET POSITION
AS OF DECEMBER 31, 2016 AND 2015

ASSETS AND DEFERRED OUTFLOWS OF RESOURCES

	2016	2015
UTILITY PLANT		
Plant in Service	\$ 364,352,298	\$ 355,828,341
Transmission System	51,350,877	49,260,677
Total	415,703,175	405,089,018
Accumulated Depreciation	(285,080,130)	(260,930,130)
Net Utility Plant	130,623,045	144,158,888
 CURRENT ASSETS		
Cash	726,324	644,653
Investments - Unrestricted	4,447,782	5,439,354
Investments - Restricted	53,842,326	65,297,725
Accounts Receivable		
Participants	3,221,887	3,061,523
Total Current Assets	62,238,319	74,443,255
 TOTAL ASSETS	 192,861,364	 218,602,143
 DEFERRED OUTFLOWS OF RESOURCES		
Cost Sharing Defined Benefit Pension Plan	118,585	22,466
 LIABILITIES, DEFERRED INFLOWS OF RESOURCES AND NET POSITION		
 LONG TERM LIABILITIES		
Revenue Bonds, Net of Current Maturities	160,535,000	187,955,000
Net Pension Liability	267,944	160,658
Total Long Term Liabilities	160,802,944	188,115,658
 CURRENT LIABILITIES		
Accounts Payable		
Participants	726,324	644,653
Minnkota Power Cooperative, Inc.	2,627,128	3,853,868
Accrued Interest	4,645,089	5,201,761
Current Maturities of Revenue Bonds	24,150,000	20,790,000
Total Current Liabilities	32,148,541	30,490,282
 TOTAL LIABILITIES	 192,951,485	 218,605,940
 DEFERRED INFLOWS OF RESOURCES		
Cost Sharing Defined Benefit Pension Plan	28,464	18,669
 NET POSITION		
Net Investment in Capital Assets	(54,061,955)	(64,586,112)
Restricted by Bond Agreements	49,197,237	60,095,964
Unrestricted	4,864,718	4,490,148
Total Net Position	\$ -	\$ -

See Notes to the Financial Statements

NORTHERN MUNICIPAL POWER AGENCY
STATEMENTS OF REVENUES AND COSTS
FOR THE YEARS ENDED DECEMBER 31, 2016 AND 2015

	2016	2015
REVENUES:		
Participants	\$ 34,422,856	\$ 33,834,095
Minnkota Power Cooperative, Inc.	19,543,718	16,128,278
Exempt Sales to Public Authorities and Other Income	<u>12,813,612</u>	<u>4,784,311</u>
Total	<u>\$ 66,780,186</u>	<u>\$ 54,746,684</u>
 COSTS:		
Plant Operations		
Fuel	\$ 15,098,323	\$ 11,099,808
Operation and Maintenance	15,902,853	10,097,949
Transmission Operations	1,765,264	1,886,127
Administrative Expense	554,849	469,279
Depreciation	<u>24,150,000</u>	<u>20,790,000</u>
Total	57,471,289	44,343,163
 Interest	 <u>9,308,897</u>	 <u>10,403,521</u>
Total	<u>\$ 66,780,186</u>	<u>\$ 54,746,684</u>

See Notes to the Financial Statements

NORTHERN MUNICIPAL POWER AGENCY
STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2016 AND 2015

	2016	2015
CASH FLOWS FROM OPERATING ACTIVITIES:		
Receipts from Participants	\$ 34,374,605	\$ 33,983,096
Receipts from Minnkota Power Cooperative, Inc.	18,342,318	13,645,040
Receipts from Other Public Authorities	7,450,551	4,958,173
Receipts from Others	395,001	317,671
Receipt of Interest	390,120	343,409
Payments for Fuel	(15,098,323)	(11,099,808)
Payments for Operating and Maintenance	(15,902,853)	(10,097,949)
Payments for Transmission Operations	(1,765,264)	(1,886,127)
Payments for Interest	(9,865,569)	(10,937,810)
Payments for Administrative Expense	<u>(473,178)</u>	<u>(100,526)</u>
Net Cash Provided (Used) by Operating Activities	<u>17,847,408</u>	<u>19,125,169</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:		
Proceeds from Issuance of Bonds	22,375,000	-
Bonds Refunded	(25,645,000)	-
Premium Received on Bonds Issued	3,178,114	-
Principal Paid on Debt	(20,790,000)	(21,015,000)
Addition to Utility Plant	<u>(9,330,936)</u>	<u>(3,967,815)</u>
Net Cash Provided (Used) by Capital and Related Financing Activities	<u>(30,212,822)</u>	<u>(24,982,815)</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Proceeds from Sale of Investments	130,254,036	136,443,391
Purchase of Investments	<u>(117,806,951)</u>	<u>(130,216,992)</u>
Net Cash Provided (Used) By Investing Activities	<u>12,447,085</u>	<u>6,226,399</u>
INCREASE IN CASH	<u>81,671</u>	<u>368,753</u>
CASH AT BEGINNING OF YEAR	<u>644,653</u>	<u>275,900</u>
CASH AT END OF YEAR	<u>\$ 726,324</u>	<u>\$ 644,653</u>
CASH FLOWS FROM OPERATING ACTIVITIES:		
Depreciation	\$ 24,150,000	\$ 20,790,000
Deferred Charges	(4,440,487)	(302,248)
Change in Current Assets and Liabilities:		
Accounts Receivable	(160,364)	34,795
Accounts Payable	(1,145,069)	(863,089)
Accrued Interest	<u>(556,672)</u>	<u>(534,289)</u>
Net Cash Provided (Used) by Operating Activities	<u>\$ 17,847,408</u>	<u>\$ 19,125,169</u>

See Notes to the Financial Statements

NORTHERN MUNICIPAL POWER AGENCY
NOTES TO THE FINANCIAL STATEMENTS
AS OF DECEMBER 31, 2016 AND 2015

NOTE 1 ORGANIZATION

Northern Municipal Power Agency (Northern) is a municipal corporation and a political subdivision of the State of Minnesota. Its membership consists of ten Minnesota and two North Dakota municipalities each of which owns and operates a municipal electric utility distribution system.

Northern was incorporated on December 14, 1976, for the purpose of providing a means for its members to secure an adequate, economical and reliable long-term supply of electric energy.

In April 1981, Northern purchased a 30% interest in the Coyote Station plant near Beulah, North Dakota and related transmission facilities from Minnkota. As of December 31, 2016, the participants in Coyote No. 1 are as follows:

Name	Percent of Ownership
Otter Tail Power Company	35%
Northern Municipal Power Agency	30%
Montana Dakota Utilities	25%
Northwestern Corporation	10%
Total	<u>100%</u>

Otter Tail Power Company is the operating agent for the Coyote Station plant.

NOTE 2 ACCOUNTING POLICIES

Basis of Accounting

Northern maintains accounting records on an accrual basis in conformity with accounting principles generally accepted in the United States of America, as applicable to governmental entities, including the application of the Government 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.

Deposits and Investments

Deposits and investments include cash and money market funds. Investments are reported on fair value based on quoted market prices as well as observable market based inputs or unobservable inputs that are corroborated by market data.

Restricted Investments

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

NORTHERN MUNICIPAL POWER AGENCY
NOTES TO THE FINANCIAL STATEMENTS - CONTINUED
AS OF DECEMBER 31, 2016 AND 2015

Fair Value Measurements

Northern accounts for all assets and liabilities that are being measured and reported on a fair value basis in accordance with generally accepted accounting principles (GAAP). GAAP defines fair value, establishes a framework for measuring fair value and expands disclosure about fair value measurements.

When fair value measurements are required, various data is used in determining those values. This statement requires that assets and liabilities that are carried at fair value must be classified and disclosed in the following levels based on the nature of the data used:

Level 1: Quoted market prices in active markets for identical assets or liabilities.

Level 2: Observable market based inputs or unobservable inputs that are corroborated by market data.

Level 3: Unobservable inputs that are not corroborated by market data.

Revenue

Revenues as defined by the Electric System Revenue Bond Resolution are established at amounts sufficient to cover operating costs (excluding depreciation) and debt service on revenue bonds, less capitalized interest. Revenues are computed and billed so that no equity is accumulated for Northern.

Utility Plant

Utility plant includes all direct acquisition costs and other costs related to the acquisition of a 30% interest in the Coyote Station plant and the related transmission facilities, along with Northern's approximate load-ratio share of Minnkota's transmission system. Bond expenses, including premiums and discounts, and interest expense (less interest earned on investment securities) are included in the cost of the utility plant.

Depreciation is provided for on a sinking fund method with depreciation equivalent to the principal payments required to pay the outstanding bonds.

Cash Flows

For purposes of the Statements of Cash Flows, Northern considers cash to be demand deposits.

Income Taxes

Northern is exempt from federal and state income taxes, as it is a political subdivision of the State of Minnesota.

Net Position

Northern has implemented GASB Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*. This statement provides guidance for reporting deferred outflows of resources, deferred inflows of resources, and net position in accordance with Concepts Statement No. 4, *Elements of Financial Statements*.

NORTHERN MUNICIPAL POWER AGENCY
NOTES TO THE FINANCIAL STATEMENTS - CONTINUED
AS OF DECEMBER 31, 2016 AND 2015

Pensions

For purposes of measuring the net pension liability, deferred outflows/inflows of resources, and pension expense, information about the fiduciary net position of the Public Employees Retirement Association (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.

Reclassifications

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

NOTE 3 POWER SUPPLY COORDINATION AGREEMENT

On March 1, 1981, Northern entered into a Power Supply Coordination Agreement with Minnkota. This agreement is effective until the later of December 31, 2031, or the date on which the Coyote Plant is retired from service. The agreement provides for Minnkota to purchase all capacity and energy in excess of Northern's requirements, subject to limitations pursuant to Federal tax law. Minnkota is the operating agent for Northern.

NOTE 4 CASH AND INVESTMENTS

The bond resolution under which the revenue bonds were issued provides for the creation and maintenance of certain funds and accounts as follows:

	December 31, 2016	December 31, 2015
Unrestricted:		
Working Fund	\$ 726,324	\$ 644,653
Operating Fund	2,000,011	3,180,254
General Reserve Fund	1,300,678	683,975
Reserve and Contingency Fund	1,146,978	1,575,125
Refunding Series 2016 - Bond Fund	115	-
Total Unrestricted	5,174,106	6,084,007
Restricted:		
Bond Fund Debt Service Reserve Account	11,250,223	15,827,630
Rate Stabilization Fund	5,632,139	4,631,675
Cost of Issuance Fund	-	4,635
2013 Plant Additions Fund	7,901,098	17,037,209
Bond Fund Interest Account	4,300,430	4,023,647
Bond Fund Principal Account	24,758,436	23,772,929
Total Restricted	53,842,326	65,297,725
Total Cash and Investments	\$ 59,016,432	\$ 71,381,732

The funds consist of \$58,290,108 of investment securities and \$726,324 of cash deposits at December 31, 2016, and \$70,737,079 of investment securities and \$644,653 of cash deposits at December 31, 2015.

NORTHERN MUNICIPAL POWER AGENCY
NOTES TO THE FINANCIAL STATEMENTS - CONTINUED
AS OF DECEMBER 31, 2016 AND 2015

As of December 31, 2016, the Agency had the following investments:

	12/31/2016	Fair Value Measurements Using			Rating	Agency
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)		
Investments by Fair Value Level						
Cash & Cash Alternatives						
Treasury Money Market	\$ 52,497,978	\$ 52,497,978	\$ -	\$ -	N/A	N/A
Debt Securities						
Federal National Mortgage	5,792,130	-	5,792,130	-	AAA	Moody's
Total Investments by Fair Value Level	<u>\$ 58,290,108</u>	<u>\$ 52,497,978</u>	<u>\$ 5,792,130</u>	<u>\$ -</u>		

Custodial Credit Risk

For an investment, custodial credit risk is the risk that, in the event of the failure of the counter party, the agency will not be able to recover the value of the investments or collateral securities that are in the possession of an outside party. The agency's investments are held by the investments counter party, in the agency's name.

Credit Risk

Northern is authorized to invest in:

- (a) Direct obligations of the U.S. Government, its agencies or instrumentalities.
- (b) New Housing Authority Bonds or Project Notes issued by public agencies or municipalities.
- (c) Direct and general obligations of any state or municipalities, which are rated "Aa".
- (d) Certificates of Deposit.
- (e) Bankers Acceptances.
- (f) Repurchase Agreements.

Interest Rate Risk

Northern has a formal investment policy that limits investment maturities as a means of managing its exposure to fair value losses arising from increasing interest rates.

Northern entered into a Forward Purchase Agreement with Barclays Bank PLC on May 30, 2014 for investing funds in the bond fund principal and bond fund interest accounts. The agreement establishes a guaranteed rate of return on the investments held in the bond fund principal and bond fund interest accounts at 1.405%. The agreement expires on January 1, 2021.

NORTHERN MUNICIPAL POWER AGENCY
NOTES TO THE FINANCIAL STATEMENTS - CONTINUED
AS OF DECEMBER 31, 2016 AND 2015

NOTE 5 UTILITY PLANT

Utility plant activity was as follows:

	Beginning Balance	Additions	Adjustments	Ending Balance
Utility Plant as of 12/31/16				
Plant in Service	\$ 355,828,341	\$ 4,062,507	\$ 4,461,450	\$ 364,352,298
Transmission System	49,260,677	2,090,200	-	51,350,877
Total Utility Plant	405,089,018	6,152,707	4,461,450	415,703,175
Less Accumulated Deprec.	(260,930,130)	(24,150,000)	-	(285,080,130)
Net Utility Plant	<u>\$ 144,158,888</u>	<u>\$ (17,997,293)</u>	<u>\$ 4,461,450</u>	<u>\$ 130,623,045</u>
 Utility Plant as of 12/31/15				
Plant in Service	\$ 352,334,517	\$ 3,034,715	\$ 459,109	\$ 355,828,341
Transmission System	48,327,577	933,100	-	49,260,677
Total Utility Plant	400,662,094	3,967,815	459,109	405,089,018
Less Accumulated Deprec.	(240,140,130)	(20,790,000)	-	(260,930,130)
Net Utility Plant	<u>\$ 160,521,964</u>	<u>\$ (16,822,185)</u>	<u>\$ 459,109</u>	<u>\$ 144,158,888</u>

The Electric System Revenue Bond Resolution requires that revenues equal costs. At December 31, 2016 and 2015, \$(1,641,457) and \$2,845,334, respectively were deferred against plant in service.

NORTHERN MUNICIPAL POWER AGENCY
NOTES TO THE FINANCIAL STATEMENTS - CONTINUED
AS OF DECEMBER 31, 2016 AND 2015

NOTE 6 REVENUE BONDS

Revenue bonds payable at December 31, 2016 and 2015 are summarized below:

	December 31, 2016	December 31, 2015
Electric System Revenue Bonds, Series 2007A, Interest 4.125% to 5.00%, due Annually In Varying Amounts from January 1, 2017 through January 1, 2020	\$ 1,975,000	\$ 28,060,000
Electric System Revenue Bonds, Series 2008A, Interest 5.00%, Due Annually in Varying Amounts from January 1, 2017 thru January 1, 2021	62,275,000	62,275,000
Electric System Revenue Bonds, Series 2008, Interest 5.82% Due January 1, 2017	17,110,000	19,610,000
Electric System Revenue Bonds, Series 2009A, Interest 5.00%, Due Annually in Varying Amounts through January 1, 2016	-	15,715,000
Electric System Revenue Bonds, Series 2010A-1, Interest 5.00%, Due Annually in Varying Amounts from January 1, 2017 through January 1, 2020	45,715,000	46,080,000
Electric System Revenue Bonds, Series 2010A-2, Interest 5.00%, Due Annually in Varying Amounts from January 1, 2022 through January 1, 2024	6,785,000	6,785,000
Electric System Revenue Bonds, Series 2010B, Interest 2.734%, Due January 1, 2016	-	1,770,000
Electric System Revenue Bonds, Series 2013A, Interest 4.00% to 5.00%, Due Annually in Varying Amounts from January 1, 2023 through January 1, 2031	26,155,000	26,155,000
Electric System Revenue Bonds, Series 2013B, Interest 4.35%, Due January 1, 2022	2,295,000	2,295,000
Electric System Revenue Bonds, Series 2016, Interest 5.00%, Due Annually in Varying Amounts from January 1, 2021 thru January 1, 2031	22,375,000	-
Totals	\$ 184,685,000	\$ 208,745,000

NORTHERN MUNICIPAL POWER AGENCY
NOTES TO THE FINANCIAL STATEMENTS - CONTINUED
AS OF DECEMBER 31, 2016 AND 2015

Revenue bond debt service requirements to maturity are as follows:

	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2017	\$ 24,150,000	\$ 9,308,898	\$ 33,458,898
2018	24,325,000	7,942,377	32,267,377
2019	24,980,000	6,730,370	31,710,370
2020	26,215,000	5,485,158	31,700,158
2021	27,715,000	4,177,689	31,892,689
2022-2026	29,055,000	10,892,363	39,947,363
2027-2031	28,245,000	4,222,268	32,467,268
	<u>\$ 184,685,000</u>	<u>\$ 48,759,123</u>	<u>\$ 233,444,123</u>

On May 4, 2016, Northern issued \$22.4 million of 2016 revenue bonds and redeemed \$25.6 million of 2007 revenue bonds. The net present value of savings on this refunding was \$3,001,974.

The principal and interest on the bonds are payable solely from and secured solely by a pledge of (1) the proceeds of the sale of the bonds to the extent held in special funds established by the Bond Resolution, (2) the revenues of Northern subject to prior payments therefrom of operating expenses and (3) all funds and accounts established by the Bond Resolution permitting the application thereof for the purpose and on the terms and conditions set forth in the Bond Resolution.

Long-term liability activity for the years ended December 31, 2016 and 2015 was as follows:

	<u>Beginning Balance</u>	<u>Net Additions</u>	<u>Net Reductions</u>	<u>Ending Balance</u>
Long-term liabilities, 12/31/16				
Revenue bonds	\$ 208,745,000	\$ 22,375,000	\$ (46,435,000)	\$ 184,685,000
Long-term liabilities, 12/31/15				
Revenue bonds	\$ 229,760,000	\$ -	\$ (21,015,000)	\$ 208,745,000

NOTE 7 DEFINED BENEFIT PENSION PLAN

Public Employees Retirement Association

Plan Description

The Agency participates in the following defined benefit pension plans administered by the Public Employees Retirement Association of Minnesota (PERA). PERA's defined benefit pension plans are 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.

NORTHERN MUNICIPAL POWER AGENCY
NOTES TO THE FINANCIAL STATEMENTS - CONTINUED
AS OF DECEMBER 31, 2016 AND 2015

1. General Employees Retirement Fund (GERF)

All full-time and certain part-time employees of the Agency are covered by the General Employees Retirement Fund (GERF). 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.

Benefits Provided

PERA provides retirement, disability, and death benefits. Benefit provisions are established by state statute and can only be modified by the state legislature.

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 following 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.

1. GERF Benefits

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.

Contributions

Minnesota Statutes Chapter 353 sets the rates for employer and employee contributions. Contribution rates can only be modified by the state legislature.

1. GERF Contributions

Basic Plan members and Coordinated Plan members were required to contribute 9.1% and 6.50%, respectively, of their annual covered salary in calendar year 2016. The Agency was required to contribute 11.78% of pay for Basic Plan members and 7.50% for Coordinated Plan members in calendar year 2016. The Agency's contributions to the GERF for the year ended December 31, 2016, were \$16,519. The Agency's contributions were equal to the required contributions as set by state statute.

NORTHERN MUNICIPAL POWER AGENCY
NOTES TO THE FINANCIAL STATEMENTS - CONTINUED
AS OF DECEMBER 31, 2016 AND 2015

GERF Pension Costs

At December 31, 2016, the Agency reported a liability of \$267,944 for its proportionate share of the GERF's net pension liability. The Agency's net pension liability reflected a reduction due to the State of Minnesota's contribution of \$6 million to the fund in 2016. The State of Minnesota is considered a non-employer contributing entity and the state's contribution meets the definition of a special funding situation. The State of Minnesota's proportionate share of the net pension liability associated with the Agency totaled \$3,559. The net pension liability was measured as of June 30, 2016, 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, 2015, through June 30, 2016, relative to the total employer contributions received from all of PERA's participating employers. At June 30, 2016 the Agency's proportion share was 0.0033% which was an increase of 0.0002% from its proportion measured as of June 30, 2015.

For the year ended December 31, 2016, the Agency recognized pension expense of \$39,729 for its proportionate share of the General Employees Plan's pension expense. In addition, the Agency recognized an additional \$1,061 as pension expense (and grant revenue) for its proportionate share of the State of Minnesota's contribution of \$6 million to the General Employees Fund. For the year ended December 31, 2015, the Agency recognized pension expense of \$17,892 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 related to pensions from the following sources:

	Deferred Outflows of Resources	Deferred Inflows of Resources
Differences between expected and actual economic experience	\$ -	\$ 21,418
Changes in actuarial assumptions	52,464	-
Difference between projected and actual investment earnings	50,121	-
Changes in proportion	7,774	7,046
Contributions paid to PERA subsequent to the measurement date	8,226	-
Total	\$ 118,585	\$ 28,464

At December 31, 2015, the Agency reported its proportionate share of GERF's deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

	Deferred Outflows of Resources	Deferred Inflows of Resources
Differences between expected and actual economic experience	\$ -	\$ 8,100
Changes in actuarial assumptions	-	-
Difference between projected and actual investment earnings	15,209	-
Changes in proportion	-	10,569
Contributions paid to PERA subsequent to the measurement date	7,257	-
Total	\$ 22,466	\$ 18,669

NORTHERN MUNICIPAL POWER AGENCY
NOTES TO THE FINANCIAL STATEMENTS - CONTINUED
AS OF DECEMBER 31, 2016 AND 2015

\$8,226 reported as deferred outflows of resources related to pensions resulting from Agency contributions subsequent to the measurement date will be recognized as a reduction of the net pension liability in the year ending December 31, 2017. Other amounts reported as deferred outflows and inflows of resources related to pensions will be recognized in pension expense as follows:

Year Ending December 31:	Pension Expense Amount
2017	\$ 21,998
2018	21,998
2019	28,221
2020	9,678
2021	-
Thereafter	-

Actuarial Assumptions

The total pension liability in the June 30, 2016, actuarial valuation was determined using the following actuarial assumptions:

Inflation	2.50% per year
Active Member Payroll Growth	3.25% per year
Investment Rate of Return	7.50%

Salary increases were based on a service-related table. Mortality rates for active members, retirees, survivors and disabilitants 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% per year for all future years for GERF.

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 GERF Plan was completed in 2015. Experience studies have not been prepared for PERA's other plans, but assumptions are reviewed annually.

The following changes in actuarial assumptions occurred in 2016:

- 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 State Board of Investment, which manages the investments of PERA, prepares an analysis of the reasonableness on a regular basis of the long-term expected rate of return 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.

NORTHERN MUNICIPAL POWER AGENCY
NOTES TO THE FINANCIAL STATEMENTS - CONTINUED
AS OF DECEMBER 31, 2016 AND 2015

The target allocation and best estimates of geometric real rates of return for each major asset class are summarized in the following table :

Asset Class	Target Allocation	Long-Term Expected Real Rate of Return
Domestic Stocks	45%	5.50%
International Stocks	15%	6.00%
Bonds	18%	1.45%
Alternative Assets	20%	6.40%
Cash	2%	0.50%
Total	100%	

Discount Rate

The discount rate used to measure the total pension liability in 2016 was 7.50%, a reduction from the 7.9% used in 2015. The projection of cash flows used to determine the discount rate assumed that contributions from plan members and employers will be made at rates set in Minnesota Statutes. Based on these assumptions, the fiduciary net position of the GERP was projected to be available to make all projected future benefit payments of current plan members. Therefore, the long-term expected rate of return on pension plan investments was applied to all periods of projected benefit payments to determine the total pension liability.

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 1 percentage point lower or 1 percentage point higher than the current discount rate:

	1% Decrease in Discount Rate (6.5%)	Discount Rate (7.5%)	1% Increase in Discount Rate (8.5%)
Agency's proportionate share of the GERP net pension liability:	\$ 380,559	\$ 267,944	\$ 175,179

Pension Plan Fiduciary Net Position

Detailed information about each defined benefit pension plan'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.

NORTHERN MUNICIPAL POWER AGENCY
NOTES TO THE FINANCIAL STATEMENTS - CONTINUED
AS OF DECEMBER 31, 2016 AND 2015

NOTE 8 RISK MANAGEMENT

Northern 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. The Reserve and Contingency Fund was established to fund uninsured risks of loss. Reserve and Contingency Fund assets were \$1,146,978 and \$1,575,125 at December 31, 2016 and 2015, respectively. There were no outstanding or unpaid claims as of December 31, 2016 and 2015. Northern continues to carry commercial insurance for other risks of loss, including workers' compensation, property and 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.

NOTE 9 COMMITMENTS AND CONTINGENCIES

The United States Environmental Protection Agency has provided Otter Tail Power Company (the operator of the Coyote Station at Beulah, North Dakota) with a Request to Provide Information Pursuant to the Clean Air Act concerning Coyote and other plants owned or operated by Otter Tail Power Company. The Environmental Protection Agency is requesting the information to determine whether the emission source is complying with the Clean Air Act. Potential penalties could be authorized by the Clean Air Act if violations were noted but since the request is in preliminary stages, it is not possible to predict if any violations and subsequent penalties would be enforced. Northern believes the Coyote Station has been operating in accordance with the Clean Air Act and expects no violations to be found.

NORTHERN MUNICIPAL POWER AGENCY
SCHEDULE OF AGENCY'S CONTRIBUTIONS TO MN PERA RETIREMENT PLAN
LAST 10 YEARS

<u>Year Ended</u> <u>December 31</u>	<u>Pension Plan</u>	<u>Statutorily</u> <u>Required</u> <u>Contribution</u>	<u>Contributions in</u> <u>Relation to the</u> <u>Statutorily Required</u> <u>Contributions</u>	<u>Contribution</u> <u>Deficiency (Excess)</u>	<u>Agency's Covered-</u> <u>Employee Payroll</u>	<u>Contributions as a</u> <u>Percentage of Covered-</u> <u>Employee Payroll</u>
2015	PERA	\$ 14,232	\$ 14,232	\$ -	\$ 189,767	7.50%
2016	PERA	\$ 16,519	\$ 16,519	\$ -	\$ 220,247	7.50%

The Agency implemented GASB Statement No. 68 for its fiscal year ended December 31, 2015. Information for the prior years is not available.

See Note to the Required Supplementary Information

NORTHERN MUNICIPAL POWER AGENCY
SCHEDULE OF AGENCY'S SHARE OF THE NET PENSION LIABILITY
LAST 10 YEARS

For the Year Ended December 31	Agency's Proportion of the Net Pension Liability (Asset)	Agency's Proportionate Share of the Net Pension Liability (Asset) (a)	State of Minnesota's Proportionate Share of the Net Pension Liability (if Applicable) (b)	Proportionate Share of the Net Pension Liability and State of Minnesota's Share of the Net Pension Liability (if Applicable) (a+b)	Agency's Covered- Employee Payroll	Agency's Proportionate Share of the Net Pension Liability (Asset) as a Percentage of its Covered- Employee Payroll	Plan Fiduciary Net Position as a Percentage of the Total Pension Liability
2015 PERA	0.0031%	\$ 160,658	\$ -	\$ 160,658	\$ 189,767	84.66%	78.20%
2016 PERA	0.0033%	\$ 267,944	\$ 3,559	\$ 271,503	\$ 220,247	121.66%	68.90%

The amounts presented for each fiscal year were determined as of the measurement date of the collective net pension liability which is June 30, 2016.

The Agency implemented GASB Statement No. 68 for its fiscal year ended December 31, 2015. Information for the prior years is not available.

See Note to the Required Supplementary Information

NORTHERN MUNICIPAL POWER AGENCY
NOTE TO THE REQUIRED SUPPLEMENTARY INFORMATION
AS OF DECEMBER 31, 2016 AND 2015

NOTE 1 GENERAL EMPLOYEES FUND

2016 Changes

Changes in Actuarial Assumptions:

- 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.

2015 Changes

Changes in Plan Provisions:

- On January 1, 2015 the Minneapolis Employees Retirement Fund was merged into the General Employees Fund, which increased the total pension liability by \$1.1 billion and increased the fiduciary plan net position by \$892 million. Upon consolidation, state and employer contributions were revised.

Changes in Actuarial Assumptions:

- The assumed post-retirement benefit increase rate was changed from 1.0% per year through 2030 and 2.5% per year thereafter to 1.0% per year through 2035 and 2.5% per year thereafter.