

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

AUDITED FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2017 AND 2016

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**NORTHERN MUNICIPAL POWER AGENCY**  
**ROSTER OF BOARD OFFICIALS**  
**FOR THE YEAR ENDED DECEMBER 31, 2017**

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

Bill Masterson  
Roger Schotl  
David Larson  
Chris West  
Lucas Spaeth  
Don Martodam  
Dennis Larson  
Todd Peterson  
Leonard Bazey  
Dale Narlock  
Shannon Mortenson  
Dan Trosen

President

Lucas Spaeth

Vice-President

Chris West

Secretary-Treasurer

Dalene Monsebroten

General Manager

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, 2017 and 2016, 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, 2017 and 2016, 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 Northern's contributions to the MN PERA retirement plan, and schedule of Northern'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 25, 2018

**NORTHERN MUNICIPAL POWER AGENCY**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
**FOR THE YEARS ENDED DECEMBER 31, 2017 AND 2016**

**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, 2017 and 2016. 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**

	2017	2016	2015	2017 vs 2016	
				Dollar Change	Percent Change
Net Utility Plant	\$ 104,734,947	\$ 130,623,045	\$ 144,158,888	\$ (25,888,098)	(19.8)
Current Assets	83,186,037	62,238,319	74,443,255	20,947,718	33.7
Total Assets	<u>187,920,984</u>	<u>192,861,364</u>	<u>218,602,143</u>	<u>(4,940,380)</u>	<u>(2.6)</u>
Deferred Outflows of Resources	<u>75,338</u>	<u>118,585</u>	<u>22,466</u>	<u>(43,247)</u>	<u>(36.5)</u>
Current Liabilities	31,834,176	32,148,541	30,490,282	(314,365)	(1.0)
Long-term Liabilities	156,119,822	160,802,944	188,115,658	(4,683,122)	(2.9)
Total Liabilities	<u>187,953,998</u>	<u>192,951,485</u>	<u>218,605,940</u>	<u>(4,997,487)</u>	<u>(2.6)</u>
Deferred Inflows of Resources	<u>42,324</u>	<u>28,464</u>	<u>18,669</u>	<u>13,860</u>	<u>48.7</u>
Net Investment in Capital Assets	(75,480,053)	(54,061,955)	(64,586,112)	(21,418,098)	(39.6)
Restricted by Bond Agreements	69,638,427	49,197,237	60,095,964	20,441,190	41.5
Unrestricted	5,841,626	4,864,718	4,490,148	976,908	20.1
Total Net Position	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>-</u>

**NORTHERN MUNICIPAL POWER AGENCY**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS - CONTINUED**  
**FOR THE YEARS ENDED DECEMBER 31, 2017 AND 2016**

Condensed statements of net position highlights are as follows:

- Net utility plant decreased by approximately \$25.9 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 \$25.9 million decrease in net utility plant is mainly due to an additional year's depreciation along with a bond refinancing premium related to the issuance of new bonds in October 2017, offset by property additions.
- Current assets increased by approximately \$20.9 million. Current assets include cash, investments and accounts receivable. The increase is due to proceeds from the issuance of new bonds in October 2017.
- Current liabilities decreased by approximately \$0.3 million primarily due to a decrease in the accrued interest on revenue bonds.
- Revenue bonds, net of current maturities, decreased by approximately \$4.6 million. The decrease is due to the refunding of bonds in October 2017 as well as scheduled bond principal payments made in 2017, offset by new bonds issued.
- The net pension liability, deferred outflows of resources, and deferred inflows of resources are due to the implementation of GASB 68, which requires Northern 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, 2017, 2016 and 2015:

**Condensed Statements of Revenues and Costs**

	2017	2016	2015	2017 vs 2016	
				Dollar Change	Percent Change
Revenues	\$ 61,699,156	\$ 66,780,186	\$ 54,746,684	\$ (5,081,030)	(7.6)
Operating Costs	\$ 54,028,293	\$ 57,471,289	\$ 44,343,163	\$ (3,442,996)	(6.0)
Interest	7,670,863	9,308,897	10,403,521	(1,638,034)	(17.6)
Total Costs	\$ 61,699,156	\$ 66,780,186	\$ 54,746,684	\$ (5,081,030)	(7.6)

Condensed statements of revenues and costs highlights are as follows:

- Total revenues decreased by \$5.1 million. Revenues from exempt sales to public authorities and other income decreased by \$1.8 million. Revenues from participants increased by \$0.4 million and revenues from Minnkota Power Cooperative, Inc. (Minnkota) decreased by \$3.7 million. Revenues from exempt sales to public authorities and other income decreased primarily due to lower surplus sales from the Coyote plant. The increase in Revenues from participants is due to a 2.9% rate increase on April 1, 2017 offset by a 1.3% decrease in energy kWh sales. Revenues from Minnkota were down primarily due to there being less Coyote plant costs in 2017 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, 2017 AND 2016

- Total operating costs decreased by \$3.4 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 \$0.2 million due to slightly higher bond principal payments. Operation and maintenance expense decreased by \$6.7 million and fuel increased by \$3.3 million mainly due to there being no scheduled major Coyote generating plant overhaul in 2017.
  
- Interest expense decreased by \$1.6 million in 2017.

**DEBT ADMINISTRATION**

As of December 31, 2017, Northern had debt outstanding of approximately \$180.2 million, a decrease of approximately \$4.5 million from December 31, 2016. Northern made scheduled bond principal payments of \$24.2 million on January 3, 2017. Refunding of 2007A, 2008A and 2010A-2 Bonds was done in October 2017 along with the issuance of new bonds, which resulted in a net increase in bonds payable of \$19.7 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, 2017 AND 2016**

**ASSETS AND DEFERRED OUTFLOWS OF RESOURCES**

	2017	2016
<b>UTILITY PLANT</b>		
Plant in Service	\$ 360,829,100	\$ 364,352,298
Transmission System	53,310,977	51,350,877
Total	414,140,077	415,703,175
Accumulated Depreciation	(309,405,130)	(285,080,130)
Net Utility Plant	104,734,947	130,623,045
 <b>CURRENT ASSETS</b>		
Cash	859,048	726,324
Investments - Unrestricted	5,729,108	4,447,782
Investments - Restricted	73,338,102	53,842,326
Accounts Receivable		
Participants	3,259,779	3,221,887
Total Current Assets	83,186,037	62,238,319
 <b>TOTAL ASSETS</b>	187,920,984	192,861,364
 <b>DEFERRED OUTFLOWS OF RESOURCES</b>		
Cost Sharing Defined Benefit Pension Plan	75,338	118,585
 <b>LIABILITIES, DEFERRED INFLOWS OF RESOURCES AND NET POSITION</b>		
 <b>LONG TERM LIABILITIES</b>		
Revenue Bonds, Net of Current Maturities	155,890,000	160,535,000
Net Pension Liability	229,822	267,944
Total Long Term Liabilities	156,119,822	160,802,944
 <b>CURRENT LIABILITIES</b>		
Accounts Payable		
Participants	859,048	726,324
Minnkota Power Cooperative, Inc.	2,950,453	2,627,128
Accrued Interest	3,699,675	4,645,089
Current Maturities of Revenue Bonds	24,325,000	24,150,000
Total Current Liabilities	31,834,176	32,148,541
 <b>TOTAL LIABILITIES</b>	187,953,998	192,951,485
 <b>DEFERRED INFLOWS OF RESOURCES</b>		
Cost Sharing Defined Benefit Pension Plan	42,324	28,464
 <b>NET POSITION</b>		
Net Investment in Capital Assets	(75,480,053)	(54,061,955)
Restricted by Bond Agreements	69,638,427	49,197,237
Unrestricted	5,841,626	4,864,718
Total Net Position	\$ -	\$ -

See Notes to the Financial Statements

**NORTHERN MUNICIPAL POWER AGENCY**  
**STATEMENTS OF REVENUES AND COSTS**  
**FOR THE YEARS ENDED DECEMBER 31, 2017 AND 2016**

	2017	2016
<b>REVENUES:</b>		
Participants	\$ 34,810,272	\$ 34,422,856
Minnkota Power Cooperative, Inc.	15,865,596	19,543,718
Exempt Sales to Public Authorities and Other Income	<u>11,023,288</u>	<u>12,813,612</u>
Total	<u>\$ 61,699,156</u>	<u>\$ 66,780,186</u>
 <b>COSTS:</b>		
Plant Operations		
Fuel	\$ 18,403,057	\$ 15,098,323
Operation and Maintenance	9,194,864	15,902,853
Transmission Operations	1,501,190	1,765,264
Administrative Expense	604,182	554,849
Depreciation	<u>24,325,000</u>	<u>24,150,000</u>
Total	54,028,293	57,471,289
 Interest	 <u>7,670,863</u>	 <u>9,308,897</u>
Total	<u>\$ 61,699,156</u>	<u>\$ 66,780,186</u>

See Notes to the Financial Statements

**NORTHERN MUNICIPAL POWER AGENCY**  
**STATEMENTS OF CASH FLOWS**  
**FOR THE YEARS ENDED DECEMBER 31, 2017 AND 2016**

	2017	2016
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Receipts from Participants	\$ 34,883,049	\$ 34,374,605
Receipts from Minnkota Power Cooperative, Inc.	16,024,268	18,342,318
Receipts from Other Public Authorities	9,072,004	7,450,551
Receipts from Others	462,880	395,001
Receipt of Interest	243,606	390,120
Payments for Fuel	(18,403,057)	(15,098,323)
Payments for Operating and Maintenance	(9,194,864)	(15,902,853)
Payments for Transmission Operations	(1,501,190)	(1,765,264)
Payments for Interest	(8,616,277)	(9,865,569)
Payments for Administrative Expense	(471,458)	(473,178)
Net Cash Provided (Used) by Operating Activities	22,498,961	17,847,408
<b>CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:</b>		
Proceeds from Issuance of Bonds	59,695,000	22,375,000
Bonds Refunded	(40,015,000)	(25,645,000)
Premium Received on Bonds Issued	6,397,435	3,178,114
Principal Paid on Debt	(24,150,000)	(20,790,000)
Addition to Utility Plant	(3,516,455)	(9,330,936)
Net Cash Provided (Used) by Capital and Related Financing Activities	(1,589,020)	(30,212,822)
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Proceeds from Sale of Investments	112,877,342	130,254,036
Purchase of Investments	(133,654,559)	(117,806,951)
Net Cash Provided (Used) By Investing Activities	(20,777,217)	12,447,085
<b>INCREASE IN CASH</b>	<b>132,724</b>	<b>81,671</b>
<b>CASH AT BEGINNING OF YEAR</b>	<b>726,324</b>	<b>644,653</b>
<b>CASH AT END OF YEAR</b>	<b>\$ 859,048</b>	<b>\$ 726,324</b>
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Depreciation	\$ 24,325,000	\$ 24,150,000
Deferred Charges	(1,298,782)	(4,440,487)
Change in Current Assets and Liabilities:		
Accounts Receivable	(37,892)	(160,364)
Accounts Payable	456,049	(1,145,069)
Accrued Interest	(945,414)	(556,672)
Net Cash Provided (Used) by Operating Activities	\$ 22,498,961	\$ 17,847,408

See Notes to the Financial Statements

**NORTHERN MUNICIPAL POWER AGENCY**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**AS OF DECEMBER 31, 2017 AND 2016**

**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, 2017, 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 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.

**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, 2017 AND 2016

**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, 2017 AND 2016**

**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.

**Accounting Estimates**

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

**Subsequent Events**

Northern has evaluated subsequent events through February 25, 2018, the date which the financial statements were available to be issued.

**NOTE 3 POWER SUPPLY COORDINATION AGREEMENT**

On March 1, 1981, Northern entered into a Power Supply Coordination Agreement with Minnkota. In 2017, this agreement was amended to be effective until the later of December 31, 2041, or the date on which the operating and engineering committee under the Agreement for Sharing Ownership caused the Coyote Plant to be 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.

**NORTHERN MUNICIPAL POWER AGENCY**  
**NOTES TO THE FINANCIAL STATEMENTS - CONTINUED**  
**AS OF DECEMBER 31, 2017 AND 2016**

**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, 2017	December 31, 2016
Unrestricted:		
Cash - Working Fund	\$ 859,048	\$ 726,324
Operating Fund	2,437,834	2,000,011
General Reserve Fund	2,303,531	1,300,678
Reserve and Contingency Fund	987,743	1,146,978
Refunding Series 2016 - Bond Fund	-	115
Total Unrestricted	<u>6,588,156</u>	<u>5,174,106</u>
Restricted:		
Debt Service Reserve Account	9,887,641	11,250,223
Rate Stabilization Fund	6,007,081	5,632,139
Cost of Issuance Fund	28,158	-
2013 Plant Additions Fund	4,325,378	7,901,098
2017 Coyote Project Construction Fund	10,423,102	-
2017 Plant Additions Fund	14,471,212	-
Bond Fund Interest Account	3,699,702	4,300,430
Bond Fund Principal Account	<u>24,495,828</u>	<u>24,758,436</u>
Total Restricted	<u>73,338,102</u>	<u>53,842,326</u>
Total Cash and Investments	<u>\$ 79,926,258</u>	<u>\$ 59,016,432</u>

The funds consist of \$79,067,210 of investment securities and \$859,048 of cash deposits at December 31, 2017, and \$58,290,108 of investment securities and \$726,324 of cash deposits at December 31, 2016.

As of December 31, 2017, Northern had the following investments:

	Fair Value Measurements Using				Rating	Agency
	12/31/2017	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)		
<b>Investments by Fair Value Level</b>						
Cash & Cash Alternatives						
Treasury Money Market	\$ 36,057,375	\$ 36,057,375	\$ -	\$ -	N/A	N/A
Certificate of Deposit	24,894,313	24,894,313	-	-	N/A	N/A
Debt Securities						
Bonds	8,246,484	-	8,246,484	-	A3	Moody's
Federal Home Loan Mortgage Corp.	1,964,365	-	1,964,365	-	Aaa	Moody's
Federal National Mortgage	<u>7,904,673</u>	-	<u>7,904,673</u>	-	Aaa	Moody's
Total Investments by Fair Value Level	<u>\$ 79,067,210</u>	<u>\$ 60,951,688</u>	<u>\$ 18,115,522</u>	<u>\$ -</u>		

**NORTHERN MUNICIPAL POWER AGENCY**  
**NOTES TO THE FINANCIAL STATEMENTS - CONTINUED**  
**AS OF DECEMBER 31, 2017 AND 2016**

**Custodial Credit Risk**

For an investment, custodial credit risk is the risk that, in the event of the failure of the counter party, Northern will not be able to recover the value of the investments or collateral securities that are in the possession of an outside party. Northern's investments are held by the investments counter party, in Northern'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. This agreement was amended on September 27, 2017 to include the 2017 Bonds. The amended agreement establishes a guaranteed rate of return on the investments held in the bond fund principal and bond fund interest accounts at 1.455%. The agreement expires on January 1, 2026.

**NOTE 5 UTILITY PLANT**

Utility plant activity was as follows:

	Beginning Balance	Additions	Adjustments	Ending Balance
Utility Plant as of 12/31/17				
Plant in Service	\$ 364,352,298	\$ 2,005,915	\$ (5,529,113)	\$ 360,829,100
Transmission System	51,350,877	1,960,100	-	53,310,977
Total Utility Plant	415,703,175	3,966,015	(5,529,113)	414,140,077
Less Accumulated Deprec.	<u>(285,080,130)</u>	<u>(24,325,000)</u>	-	<u>(309,405,130)</u>
Net Utility Plant	<u>\$ 130,623,045</u>	<u>\$ (20,358,985)</u>	<u>\$ (5,529,113)</u>	<u>\$ 104,734,947</u>
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.	<u>(260,930,130)</u>	<u>(24,150,000)</u>	-	<u>(285,080,130)</u>
Net Utility Plant	<u>\$ 144,158,888</u>	<u>\$ (17,997,293)</u>	<u>\$ 4,461,450</u>	<u>\$ 130,623,045</u>

**NORTHERN MUNICIPAL POWER AGENCY**  
**NOTES TO THE FINANCIAL STATEMENTS - CONTINUED**  
**AS OF DECEMBER 31, 2017 AND 2016**

The Electric System Revenue Bond Resolution requires that revenues equal costs. At December 31, 2017 and 2016, \$(2,794,570) and \$(1,641,457), respectively were deferred against plant in service.

**NOTE 6 REVENUE BONDS**

Revenue bonds payable at December 31, 2017 and 2016 are summarized below:

	December 31, 2017	December 31, 2016
Electric System Revenue Bonds, Series 2007A, Interest 4.125% to 5.00%, due Annually In Varying Amounts from Jan. 1, 2018 through Jan. 1, 2020	\$ 485,000	\$ 1,975,000
Electric System Revenue Bonds, Series 2008A, Interest 5.00%, Due Annually in Varying Amounts from Jan. 1, 2018 through Jan. 1, 2021	23,665,000	62,275,000
Electric System Revenue Bonds, Series 2008, Interest 5.82% Due Jan. 1, 2017	-	17,110,000
Electric System Revenue Bonds, Series 2010A-1, Interest 5.00%, Due Annually in Varying Amounts from Jan. 1, 2018 through Jan. 1, 2020	45,545,000	45,715,000
Electric System Revenue Bonds, Series 2010A-2, Interest 5.00%, Due Annually in Varying Amounts from Jan. 1, 2022 through Jan. 1, 2024	-	6,785,000
Electric System Revenue Bonds, Series 2013A, Interest 4.00% to 5.00%, Due Annually in Varying Amounts from Jan. 1, 2023 through Jan. 1, 2031	26,155,000	26,155,000
Electric System Revenue Bonds, Series 2013B, Interest 4.35%, Due Jan. 1, 2022	2,295,000	2,295,000
Electric System Revenue Bonds, Series 2016, Interest 5.00%, Due Annually in Varying Amounts from Jan. 1, 2021 through Jan. 1, 2031	22,375,000	22,375,000
Electric System Revenue Bonds, Series 2017, Interest 4.00% to 5.00% Due Annually in Varying Amounts from Jan. 1, 2019 through Jan. 1, 2041	59,695,000	-
Totals	\$ 180,215,000	\$ 184,685,000

**NORTHERN MUNICIPAL POWER AGENCY**  
**NOTES TO THE FINANCIAL STATEMENTS - CONTINUED**  
**AS OF DECEMBER 31, 2017 AND 2016**

Revenue bond debt service requirements to maturity are as follows:

	Principal	Interest	Total
2018	\$ 24,325,000	\$ 7,670,863	\$ 31,995,863
2019	23,865,000	7,703,939	31,568,939
2020	25,025,000	6,528,189	31,553,189
2021	26,505,000	5,276,939	31,781,939
2022	8,210,000	3,951,689	12,161,689
2023-2027	32,595,000	14,326,280	46,921,280
2028-2032	29,190,000	6,435,912	35,625,912
2033-2037	6,850,000	1,887,750	8,737,750
2038-2041	3,650,000	467,500	4,117,500
	<u>\$ 180,215,000</u>	<u>\$ 54,249,061</u>	<u>\$ 234,464,061</u>

On October 3, 2017, Northern issued \$59.7 million of 2017 revenue bonds and redeemed \$40.0 million of 2007, 2008 and 2010 revenue bonds. The net present value of savings on this refunding was \$3,229,993.

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, 2017 and 2016 was as follows:

	Beginning Balance	Net Additions	Net Reductions	Ending Balance
Long-term liabilities, 12/31/17				
Revenue bonds	\$ 184,685,000	\$ 59,695,000	\$ (64,165,000)	\$ 180,215,000
Long-term liabilities, 12/31/16				
Revenue bonds	\$ 208,745,000	\$ 22,375,000	\$ (46,435,000)	\$ 184,685,000

**NOTE 7 DEFINED BENEFIT PENSION PLAN**

**Public Employees Retirement Association**

**Plan Description**

Northern participates in the following cost-sharing multiple-employer 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, 2017 AND 2016

1. General Employees Retirement Plan (General Employees Plan (accounted for in the General Employees Fund))

All full-time and certain part-time employees of Northern are covered by the General Employees Retirement Plan. General Employees Plan 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. General Employees Plan Benefits

General Employees Plan 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. General Employees Fund 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 2017. Northern was required to contribute 11.78% of pay for Basic Plan members and 7.50% for Coordinated Plan members in calendar year 2017. Northern's contributions to the General Employees Fund for the year ended December 31, 2017, were \$18,672. Northern'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, 2017 AND 2016**

**General Employees Fund Pension Costs**

At December 31, 2017, Northern reported a liability of \$229,822 for its proportionate share of the General Employees Fund's net pension liability. Northern's net pension liability reflected a reduction due to the State of Minnesota's contribution of \$6 million to the fund in 2017. 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 Northern totaled \$2,920. The net pension liability was measured as of June 30, 2017, and the total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of that date. Northern's proportion of the net pension liability was based on Northern's contributions received by PERA during the measurement period for employer payroll paid dates from July 1, 2016, through June 30, 2017, relative to the total employer contributions received from all of PERA's participating employers. At June 30, 2017, Northern's proportion share was 0.0036% which was an increase of 0.0003% from its proportion measured as of June 30, 2016.

For the year ended December 31, 2017, Northern recognized pension expense of \$15,516 for its proportionate share of the General Employees Plan's pension expense. In addition, Northern recognized an additional \$84 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, 2016, Northern recognized pension expense of \$39,729 for its proportionate share of the General Employees Plan's pension expense.

At December 31, 2017, Northern reported its proportionate share of the General Employees Plan'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	\$ 7,574	\$ 13,379
Changes in actuarial assumptions	34,976	23,040
Difference between projected and actual investment earnings	-	2,382
Changes in proportion	23,452	3,523
Contributions paid to PERA subsequent to the measurement date	9,336	-
Total	\$ 75,338	\$ 42,324

At December 31, 2016, Northern reported its proportionate share of the General Employees Plan'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

**NORTHERN MUNICIPAL POWER AGENCY**  
**NOTES TO THE FINANCIAL STATEMENTS - CONTINUED**  
**AS OF DECEMBER 31, 2017 AND 2016**

\$9,336 reported as deferred outflows of resources related to pensions resulting from Northern contributions subsequent to the measurement date will be recognized as a reduction of the net pension liability in the year ending December 31, 2018. Other amounts reported as deferred outflows and deferred inflows of resources related to pensions will be recognized in pension expense as follows:

Year Ending December 31:	Pension Expense Amount
2018	\$ 13,177
2019	19,400
2020	857
2021	(9,756)
2022	-
Thereafter	-

**Actuarial Assumptions**

The total pension liability in the June 30, 2017 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 to fit PERA's experience. Cost of living benefit increases for retirees are assumed to be 1.0% per year for the General Employees Plan through 2044 and then 2.5% thereafter.

Actuarial assumptions used in the June 30, 2017 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 2017:

- The Combined Service Annuity (CSA) loads were changed from 0.8% for active members and 60% for vested and non-vested deferred members. The revised CSA loads are now 0.0% for active member liability, 15.0% for vested deferred member liability and 3.0% for non-vested deferred member liability.
- The assumed post-retirement benefit increase rate was changed from 1.0 % per year for all years to 1.0% per year through 2044 and 2.5% per year thereafter.

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

**NORTHERN MUNICIPAL POWER AGENCY**  
**NOTES TO THE FINANCIAL STATEMENTS - CONTINUED**  
**AS OF DECEMBER 31, 2017 AND 2016**

<b>Asset Class</b>	<b>Target Allocation</b>	<b>Long-Term Expected Real Rate of Return</b>
Domestic Stocks	39%	5.10%
International Stocks	19%	5.30%
Bonds	20%	0.75%
Alternative Assets	20%	5.90%
Cash	2%	0.00%
Total	100%	

**Discount Rate**

The discount rate used to measure the total pension liability in 2017 was 7.50%. 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 General Employees Fund 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 Northern'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 Northern'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:

	1% Decrease in Discount Rate (6.5%)	Discount Rate (7.5%)	1% Increase in Discount Rate (8.5%)
Northern's proportionate share of the GERF net pension liability:	\$ 356,470	\$ 229,822	\$ 126,137

**Pension Plan Fiduciary Net Position**

Detailed information about each 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](http://www.mnpera.org).

**NORTHERN MUNICIPAL POWER AGENCY**  
**NOTES TO THE FINANCIAL STATEMENTS - CONTINUED**  
**AS OF DECEMBER 31, 2017 AND 2016**

**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 \$987,743 and \$1,146,978 at December 31, 2017 and 2016, respectively. There were no outstanding or unpaid claims as of December 31, 2017 and 2016. 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.

**NOTE 10 RECLASSIFICATIONS**

Certain 2016 amounts have been reclassified to conform to the 2017 presentation.

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

<u>Year Ended December 31</u>	<u>Pension Plan</u>	<u>Statutorily Required Contribution</u>	<u>Contributions in Relation to the Statutorily Required Contributions</u>	<u>Contribution Deficiency (Excess)</u>	<u>Northern's Covered- Employee Payroll</u>	<u>Contributions as a Percentage of Covered- Employee Payroll</u>
2015	PERA	\$ 14,232	\$ 14,232	\$ -	\$ 189,767	7.50%
2016	PERA	\$ 16,519	\$ 16,519	\$ -	\$ 220,247	7.50%
2017	PERA	\$ 18,672	\$ 18,672	\$ -	\$ 248,954	7.50%

Northern 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 NORTHERN'S SHARE OF THE NET PENSION LIABILITY**  
**LAST 10 YEARS**

For the Year Ended December 31	Northern's Proportion of the Net Pension Liability (Asset)	Northern'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)	Northern's Covered- Employee Payroll	Northern'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%
2017 PERA	0.0036%	\$ 229,822	\$ 2,920	\$ 232,742	\$ 248,954	92.32%	75.90%

The amounts presented for each fiscal year were determined as of the measurement date of the collective net pension liability which is June 30, 2017.

Northern 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, 2017 AND 2016

**NOTE 1 GENERAL EMPLOYEES FUND**

***2017 Changes***

Changes in Actuarial Assumptions:

- The Combined Service Annuity (CSA) loads were changed from 0.8% for active members and 60% for vested and non-vested deferred members. The revised CSA loads are now 0.0% for active member liability, 15.0% for vested deferred member liability and 3.0% for non-vested deferred member liability.

- The assumed post-retirement benefit increase rate was changed from 1.0% per year for all years to 1.0% per year through 2044 and 2.5% per year thereafter.

***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.