SOUTHERN MINNESOTA MUNICIPAL POWER AGENCY

Financial Statements

December 31, 2017 and 2016

(With Independent Auditors' Report Thereon)

SOUTHERN MINNESOTA MUNICIPAL POWER AGENCY

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KPMG LLP
4200 Wells Fargo Center
90 South Seventh Street
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Independent Auditors' Report

The Board of Directors
Southern Minnesota Municipal Power Agency:

We have audited the accompanying financial statements of Southern Minnesota Municipal Power Agency (the Agency) as of and for the years ended December 31, 2017 and 2016, and the related notes to the financial statements, which collectively comprise the Agency's basic financial statements for the years then ended as listed in the table of contents.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

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

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Southern Minnesota Municipal Power Agency as of December 31, 2017 and 2016, and the changes in its financial position and its cash flows for the years then ended, in accordance with U.S. generally accepted accounting principles.

Other Matter

U.S. generally accepted accounting principles require that the management's discussion and analysis on pages 3 through 12, the schedule of the Agency's proportionate share of net pension liability on page 38, and the schedule of the Agency's contributions on page 39 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

KPMG LLP

Minneapolis, Minnesota
March 8, 2018

Financial Statements Overview

This discussion and analysis of Southern Minnesota Municipal Power Agency's (the Agency) financial performance provides an overview of the Agency's activities for the fiscal years ended December 31, 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 U.S. generally accepted accounting principles. The Agency complies with all applicable pronouncements of the Governmental Accounting Standards Board (GASB). This includes GASB Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*. GASB Statement No. 62 incorporates into the GASB's authoritative literature certain accounting and financial reporting guidance that is included in the Financial Accounting Standards Board and American Institute of Certified Public Accountants' pronouncements issued on or before November 30, 1989, which does not conflict with GASB pronouncements. The Agency follows the Uniform System of Accounts prescribed by the Federal Energy Regulatory Commission.

The Agency's basic financial statements include the statements of net position; the statements of revenue, expenses, and changes in net position; and the statements of cash flows. The statements of net position provide information about the nature and amount of assets and obligations (liabilities) of the Agency as of December 31, 2017 and 2016. The statements of revenue, expenses, and changes in net position report revenue and expenses for the years ended December 31, 2017 and 2016. The statements of cash flows report cash receipts, cash payments, and net changes in cash resulting from operating activities, noncapital financing activities, capital and related financing activities, and investing activities.

Summary of Significant Resources and Financing Activities

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

Owatonna Energy Station

The Owatonna Energy Station, a 38 MW high-efficiency natural gas–fired generating station near Owatonna, Minnesota, is in the commissioning and testing phase of the project. The project consists of four 20-cylinder Caterpillar internal combustion engines and is expected to go into commercial operations in the first half of 2018. At the end of 2017, there was $39.0 million in construction work in progress on the Agency's statement of net position, of which $2.4 million is allowance for funds used during construction (AFUDC, or sometimes referred to as capitalized interest during construction). Construction of the project was funded by a combination of variable rate short–term debt and cash reserves as prescribed in the board resolutions approving the project in March 2015. In October of 2017, Series 2017A fixed rate 30-year revenue bonds were issued to repay the short-term debt used on the project.

Badger Coulee Transmission Project

SMMPA Wisconsin LLC (the LLC), a wholly owned subsidiary of the Agency, owns a 6.5% undivided ownership interest in the Badger Coulee 345 kV transmission line extending from the Briggs Road substation near La Crosse, Wisconsin to the North Madison substation near Madison, Wisconsin. As of December 31, 2017, the LLC has incurred $16.5 million of capital expenditures, which is slightly over 50.0% of the total expenditures expected on the project. The Agency is currently financing the project with U.S. Bank variable rate short-term

borrowing program under the Badger Coulee Project Bond Resolution. The project-based financing allows the flexibility for certain members whose power sales contracts expire in 2030 to participate in the Badger Coulee project as project participants beyond the expiration of their power sales contracts. The project is designated as a multivalue project by the Midcontinent Independent System Operator (MISO). The variable rate short-term loan program is based on the one-month LIBOR index adjusted to reflect the Agency's tax-exempt status. There is a fee on the unused portion of the program.

Other Resources

- **Stoneray Power Partners LLC**

  On May 17, 2017, the Agency entered into a 20-year purchased power agreement with Stoneray Power Partners LLC, a subsidiary of EDF Renewable Energy, Inc., to purchase the energy output from approximately 50 wind turbines, with a nameplate capacity of 100 MW beginning in 2020. The wind turbines will be located in Pipestone and Murray counties in Minnesota. Power deliveries will begin in 2020. In compliance with MISO requirements for new renewable energy, the output will be dispatchable. The Stoneray contract, along with the existing Wapsicon wind contract, which ends in 2029, will enable the Agency to comply with the Minnesota Renewable Energy Standard.

- **Lemond Solar Center**

  On May 25, 2016, the Agency entered into a 20-year power purchase agreement with Lemond Solar Center, LLC (Lemond), a subsidiary of Enerparc, Inc. of Oakland, California, to purchase the output from a five MW solar facility constructed near Owatonna, Minnesota. The Lemond Solar Center began commercial operation at the end of June 2017. The Agency subsequently entered into an agreement to sell 280 kW from the project to Central Municipal Power Agency and Services.

Agency Financings and Wholesale Power Rate Action

The Agency entered into a Revolving Credit Agreement (RCA) with U.S. Bank on January 11, 2017. The RCA replaces the Agency's commercial paper program. The RCA is a U.S. Bank variable rate short-term program with a 3.5-year term with an option to extend the agreement. The financing is in the form of advances made by U.S. Bank to the Agency up to a maximum program size of $68.0 million. Interest on the advanced funds is based on the one-month LIBOR index adjusted to reflect the Agency's tax-exempt status plus an applicable spread. There is a fee on the unused portion of the program. The Agency had $19.5 million in outstanding RCA advances at the end of 2017.

On October 11, 2017, the Agency closed on the issuance of $23.8 million (par value) in fixed rate 30-year bonds, the Power Supply Revenue Bonds, Series 2017A. The principal amount of the bonds, combined with the original issue premium of $4.1 million, provided a total of $27.9 million in sources of funds. The bond proceeds were used by the Agency to repay $26.2 million in short-term variable rate debt used to fund the construction of the Owatonna Energy Station, fund the required deposit in the debt service reserve account of $1.6 million, and pay issuance costs of $0.1 million.

No Change in Wholesale Power and Energy Rates

At its October 13, 2017 meeting, the board of directors approved a recommendation for no increase in the Agency's wholesale power and energy rates in 2018.

Financial Highlights – 2017

Condensed Statements of Net Position

($millions)

Assets		**2017**	**2016**	**2017 to 2016 change**
Current assets	$	217.7	214.0	3.7
Noncurrent assets:				
Capital assets, net		519.7	502.9	16.8
Noncurrent investments		73.7	74.1	(0.4)
Future recoverable costs		175.1	193.0	(17.9)
Deferred outflows:				
Deferred outflows – advance refunding of debt		4.4	9.1	(4.7)
Deferred outflows of pension resources		1.3	3.1	(1.8)
Accumulated decrease in fair value of derivative instruments – noncurrent		—	0.2	(0.2)
Total assets and deferred outflows	$	991.9	996.4	(4.5)
Liabilities				
Current liabilities	$	122.5	127.5	(5.0)
Long-term liabilities:				
Long-term debt, net		581.6	595.3	(13.7)
Derivative instruments – swap liability		—	0.2	(0.2)
Pension liability		5.2	6.5	(1.3)
Deferred inflows:				
Deferred credits rate stabilization		94.2	94.5	(0.3)
Deferred gain on involuntary conversion of plant assets		55.4	58.6	(3.2)
Deferred inflows of pension resources		1.3	1.4	(0.1)
Total liabilities and deferred inflows		860.2	884.0	(23.8)
Net position:				
Invested in capital assets		218.1	169.7	48.4
Restricted		69.4	66.9	2.5
Unrestricted		(155.8)	(124.2)	(31.6)
Total net position		131.7	112.4	19.3
Total liabilities, deferred inflows, and net position	$	991.9	996.4	(4.5)

(Continued)

Condensed statements of net position highlights are as follows:

- The assets and deferred outflows of the Agency exceeded its liabilities and deferred inflows at the close of 2017 by approximately $131.7 million.
- Current assets increased by approximately $3.7 million in 2017. Current assets include deposits and investments held in revenue and operating funds of approximately $29.5 million at December 31, 2017 to be used for operating, maintenance, and working capital needs of the Agency, which decreased by approximately $1.5 million in 2017. Current assets at December 31, 2017 also include deposits and investments held in restricted funds of approximately $72.3 million in accordance with the bond resolution for debt service requirements, which decreased by approximately $0.1 million.
- Current assets included a decrease of approximately $7.2 million in fuel stock, an increase of approximately $10.6 million in other unrestricted funds, an increase of approximately $1.3 million in rate stabilization funds, and an increase of approximately $0.6 million in power sales revenue receivables.
- Capital assets, net increased by approximately $16.8 million during 2017. Capital assets, net include the Agency's 41% undivided ownership interest in Sherco 3 plant with a historical cost of approximately $560.0 million as of December 31, 2017. The Agency also has approximately $267.0 million on a historical cost basis of Agency-owned generating facilities, substation facilities, transmission lines, land, wind turbines, buildings, upgrades to members' generating units under contract, and general office equipment recorded as of the end of 2017.
- For 2017, the increase in capital assets, net was the result of a decrease in electric plant and equipment, net of approximately $17.9 million and a net increase in construction work in progress of approximately $34.7 million, an increase of approximately $2.7 million in electric plant and equipment, offset by an increase in accumulated depreciation of approximately $20.6 million.
- Noncurrent investments, which include investments held in restricted funds in accordance with the bond resolution for debt service reserves, were approximately $73.7 million in 2017.
- Future recoverable costs represent costs in excess of the amounts currently billable to the members who are to be recovered from future revenue by setting rates sufficient to provide funds for the related debt service payments and the balance decreased by approximately $17.9 million in 2017.
- Deferred outflows – advance refunding of debt decreased by $4.7 million as a result of the combined effects of amortization and deferred outflows resulting from the advance refunding of callable Series 2006A and 2009A revenue bonds.
- Deferred outflows of pension resources for 2017 were $1.3 million. The deferred inflows and outflows of pension resources are amounts used under GASB Statement No. 68 in developing the annual pension expense. Deferred inflows and outflows arise with differences between expected and actual experiences and changes of assumptions.
- Current liabilities decreased by approximately $5.0 million in 2017. The current portion of long-term debt of approximately $63.9 million at December 31, 2017, and notes payable of $33.5 million are included in current liabilities. Attributable to the total decrease in total current liabilities was a $1.8 million increase in accounts payable – power production, a $2.8 million decrease in accrued liabilities and other payables, an increase of approximately $3.8 million in current maturities of long-term debt, an increase in accrued interest payable of $1.2 million, and a decrease in notes payable of $6.5 million.

- The carrying value of long-term debt at the end of 2017 was approximately $581.6 million. Scheduled principal payments of approximately $60.1 million were made in 2017.
- Pension liability was approximately $5.2 million at the end of 2017, a decrease of approximately $1.3 million during 2017.
- Deferred inflows, current and long-term deferred credits rate stabilization, decreased by approximately $0.3 million. The decrease was a result of net distributions from the fund during 2017.
- Deferred inflows, gain on involuntary conversion of plant assets, current and long term decreased by approximately $3.3 million in 2017.
- Deferred inflows of pension resources were approximately $1.3 million at the end of 2017. The deferred inflows and outflows of pension resources are amounts used under GASB Statement No. 68 in developing the annual pension expense. Deferred inflows and outflows arise with differences between expected and actual experiences and changes of assumptions.

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

($millions)

		2017	2016	2017 to 2016 change
Operating revenue, power sales	$	240.1	235.7	4.4
Other revenue		3.7	2.8	0.9
Total revenue		243.8	238.5	5.3
Operating expenses		178.8	183.9	(5.1)
Interest expense, net		45.7	45.7	—
Total expenses		224.5	229.6	(5.1)
Change in net position		19.3	8.9	10.4
Beginning net position		112.4	103.5	8.9
Ending net position	$	131.7	112.4	19.3

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

- Operating revenue, power sales increased by approximately $4.4 million between 2017 and 2016. Operating revenue, power sales consist principally of member's power sales revenue, power sales to nonmembers, other transmission revenue, and contributions to, or distributions from, the rate stabilization account. Sales to nonmembers include the Agency's participation in the MISO Day 2 market.

- In 2017, before the effects of distributions made from the rate stabilization account, operating revenue, power sales decreased by approximately $2.0 million, primarily due to increases in the member's sales of $3.1 million, decreases in MISO energy market sales of $10.8 million, and an increase in transmission service agreement revenue by $5.5 million. There was a net distribution of approximately $0.3 million from the rate stabilization account in 2017 compared with a net contribution of approximately $6.1 million in 2016. The net distribution from the rate stabilization account in 2017 included a onetime transfer of $10.0 million from the rate stabilization account to the equity construction account as part of the cash financing required to fund a portion of the CapX 2020 transmission project. Contributions to the rate stabilization account decrease the amount of operating revenue, power sales, whereas distributions from the rate stabilization account increase the amount of operating revenue, power sales as funds are added to, or subtracted from, the rate stabilization account, which is included in deferred inflows.
- There was an increase of approximately $0.9 million in other revenue between 2017 and 2016. Other revenue includes the Build America Bonds (BABs) interest subsidy, investment earnings, and rental income.
- Operating expenses decreased by approximately $5.1 million between 2017 and 2016. Operating expenses consist of production fuel, power production, other operating expenses, depreciation and amortization, and expenses to be recovered in future periods. The decrease observed in 2017, compared with 2016, was the net result of a decrease in production fuel expense of approximately $12.7 million due to a planned overhaul at Sherco 3, an increase in power production expenses of approximately $0.2 million, an increase in other operating expenses of approximately $6.0 million (consisting mainly of a decrease of approximately $0.2 million in transmission expenses, an increase of approximately $1.8 million in Sherco 3 operating and maintenance expenses, an increase of approximately $0.9 million in administrative and general expenses, an increase of approximately $3.2 million in lieu of property taxes, an increase of approximately $0.3 million in other Agency-owned generation) and a combined increase of approximately $1.4 million in depreciation and deferred costs expensed in current period.

- Financial Highlights – 2016

Condensed Statements of Net Position

($millions)

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

(Continued)

Condensed statements of net position highlights are as follows:

- The assets and deferred outflows of the Agency exceeded its liabilities and deferred inflows at the close of 2016 by approximately $112.4 million.
- Current assets decreased by approximately $8.4 million in 2016. Current assets include deposits and investments held in revenue and operating funds of approximately $31.1 million at December 31, 2016 to be used for operating, maintenance, and working capital needs of the Agency, and increased by approximately $1.2 million in 2016. Current assets at December 31, 2016 also include deposits and investments held in restricted funds of approximately $72.4 million in accordance with the bond resolution for debt service requirements, which decreased by approximately $5.3 million.
- Current assets included an increase of approximately $6.8 million in fuel stock, a decrease of approximately $13.8 million in other unrestricted funds and an increase of approximately $1.4 million in power sales revenue receivables.
- Capital assets, net increased by approximately $14.2 million during 2016. Capital assets, net include the Agency's 41% undivided ownership interest in Sherco 3 plant with a historical cost of approximately $560.2 million as of December 31, 2016. The Agency also has approximately $264.1 million on a historical cost basis of Agency-owned generating facilities, substation facilities, transmission lines, land, wind turbines, buildings, upgrades to members' generating units under contract, and general office equipment recorded as of the end of 2016.
- For 2016, the increase in capital assets, net was the result of an increase in electric plant and equipment, net of approximately $17.3 million and a net decrease in construction work in progress of approximately $3.2 million. The increase in electric plant and equipment, net was a result of an increase of approximately $37.0 million for the construction of transmission assets, and a decrease of approximately $0.5 million in Sherco 3 and other capital improvements, offset by an increase in accumulated depreciation of approximately $19.2 million.
- Noncurrent investments, which include investments held in restricted funds in accordance with the bond resolution for debt service reserves, were approximately $74.1 million in 2016.
- Future recoverable costs represent costs in excess of the amounts currently billable to the members that are to be recovered from future revenue by setting rates sufficient to provide funds for the related debt service payments, the balance decreased by approximately $14.8 million in 2016.
- Deferred outflows – Advance refunding of debt decreased by $5.9 million as a result of the combined effects of amortization and deferred outflows resulting from the advance refunding of callable Series 2006A and 2009A revenue bonds in 2016.
- Deferred outflows of pension resources for 2016 were $3.1 million. The deferred inflows and outflows of pension resources are amounts used under GASB Statement No. 68 in developing the annual pension expense. Deferred inflows and outflows arise with differences between expected and actual experiences and changes of assumptions.
- Current liabilities increased by approximately $12.3 million in 2016. The current portion of long-term debt of approximately $60.1 million at December 31, 2016 and notes payable of $40.0 million are included in current liabilities. Attributable to the total increase in total current liabilities was a $2.0 million increase in accounts payable – power production, a $1.0 million increase in accrued liabilities and other payables, an

increase of approximately $4.4 million in current maturities of long-term debt, and an increase in notes payable of $5.0 million.

- The carrying value of long-term debt at the end of 2016 was approximately $595.3 million. Scheduled principal payments of approximately $55.7 million were made in 2016.
- Pension liability was approximately $6.5 million at the end of 2016, an increase of approximately $2.2 million during 2016.
- Deferred inflows, current and long-term deferred credits rate stabilization increased by approximately $6.1 million. The increase was a result of net contributions to the account during 2016.
- Deferred inflows, gain on involuntary conversion of plant assets, current and long term decreased by approximately $3.3 million in 2016.
- Deferred inflows of pension resources was approximately $1.4 million at the end of 2016. The deferred inflows and outflows of pension resources are amounts used under GASB Statement No. 68 in developing the annual pension expense. Deferred inflows and outflows arise with differences between expected and actual experiences and changes of assumptions.

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

($millions)

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

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

- Operating revenue, power sales increased by approximately $4.1 million between 2016 and 2015. Operating revenue, power sales consist principally of member's power sales revenue, power sales to nonmembers, other transmission revenue, and contributions to, or distributions from, the rate stabilization account. Sales to nonmembers include the Agency's participation in the MISO Day 2 market.

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

Debt Administration

As of December 31, 2017 and 2016, the carrying value of the Agency's total long-term debt outstanding, including current maturities, was approximately $645.5 million and $655.4 million, respectively. The decrease in 2017 was the net result of scheduled amortization of long-term debt and the bond discount/premium amounts. Current liabilities include Notes Payable of $33.5 million as of December 31, 2017 and $40.0 million in 2016. Notes payable as of December 31, 2017 consisted of $19.5 million in revolving credit advances outstanding and $14.0 million in funds advanced from the Badger Coulee project short-term financing program. Notes payable as of December 31, 2016 included $35.0 million of short-term commercial paper notes and $5.0 million advanced from the Badger Coulee project short-term financing program. In January 2017, the Agency converted its short-term commercial paper program into a revolving credit agreement with U.S. Bank.

In October 2017, the Agency issued Series 2017A bonds with a par value of $23.8 million and total proceeds of $27.4 million to pay down the revolving credit agreement funds used for the construction of the Owatonna Energy Station.

Contact Information

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

SOUTHERN MINNESOTA MUNICIPAL POWER AGENCY

Statements of Net Position

December 31, 2017 and 2016

Assets	**2017**	**2016**
Current assets:		
Cash	$ 30,955	42,533
Investments:		
Unrestricted funds:		
Revenue and operating funds	29,546,994	31,083,103
Rate stabilization	67,261,002	65,955,166
Other	11,177,961	552,805
Restricted funds	72,303,505	72,401,682
Power sales revenue receivables	17,825,535	17,253,702
Accrued interest receivable	588,587	537,350
Fuel stock	10,760,913	17,978,428
Material inventory	5,701,907	5,831,031
Prepaids	995,878	1,330,129
Other current assets	936,411	506,111
Escrow deposit	558,614	558,614
Total current assets	217,688,262	214,030,654
Noncurrent assets:		
Capital assets:		
Electric plant and equipment	826,986,467	824,297,175
Less accumulated depreciation and amortization	392,309,974	371,696,808
Electric plant and equipment – net	434,676,493	452,600,367
Construction work in progress	84,999,171	50,252,596
Total capital assets	519,675,664	502,852,963
Noncurrent investments:		
Restricted investment funds	73,732,265	74,116,710
Future recoverable costs	175,090,588	193,010,775
Total noncurrent assets	768,498,517	769,980,448
Total assets	986,186,779	984,011,102
Deferred Outflows		
Deferred outflows of pension resources	1,296,199	3,061,538
Deferred outflows – advance refunding of debt	4,383,588	9,126,153
Accumulated decrease in fair value of derivative instruments – noncurrent	44,528	182,480
Total assets and deferred outflows	$ 991,911,094	996,381,273
Liabilities		
Current liabilities:		
Accounts payable – power production	$ 6,654,225	4,849,603
Accrued liabilities and other payables	13,771,764	16,596,040
Accrued interest payable	4,714,177	5,954,348
Notes payable	33,500,000	40,000,000
Current maturities of long-term debt	63,875,000	60,090,000
Total current liabilities	122,515,166	127,489,991
Long-term liabilities:		
Long-term debt, net	581,619,633	595,267,058
Derivative instruments – swap liability	44,528	182,480
Pension liability	5,196,522	6,519,962
Total long-term liabilities	586,860,683	601,969,500
Total liabilities	709,375,849	729,459,491
Deferred Inflows		
Deferred credits rate stabilization – current	4,442,832	8,594,128
Gain on involuntary conversion of plant assets – current	3,254,989	3,254,989
Deferred credits rate stabilization – noncurrent	89,766,620	85,882,506
Gain on involuntary conversion of plant assets – noncurrent	52,079,831	55,334,821
Deferred inflows of pension resources	1,305,422	1,446,773
Total deferred inflows	150,849,694	154,513,217
Total liabilities and deferred inflows	860,225,543	883,972,708
Net Position		
Net investment in capital assets	218,076,328	169,712,848
Restricted by bond agreements	69,362,533	66,932,173
Unrestricted	(155,753,310)	(124,236,456)
Total net position	131,685,551	112,408,565
Total liabilities, deferred inflows, and net position	$ 991,911,094	996,381,273

See accompanying notes to financial statements.

SOUTHERN MINNESOTA MUNICIPAL POWER AGENCY

Statements of Revenue, Expenses, and Changes in Net Position

Years ended December 31, 2017 and 2016

		2017	2016
Operating revenue, power sales	$	240,125,850	235,715,851
Operating expenses:			
Production fuel		16,788,000	29,488,186
Power production		66,342,431	66,118,557
Other operating expenses		69,530,202	63,549,666
Depreciation and amortization		17,865,024	18,159,671
Deferred costs expensed in current period		8,316,431	6,552,723
Total operating expenses		178,842,088	183,868,803
Operating income		61,283,762	51,847,048
Nonoperating (income) expenses:			
Investment earnings		(2,496,191)	(1,598,375)
Miscellaneous income		(1,225,279)	(1,223,972)
Interest expense		8,034,701	10,340,579
Amortization of long-term debt issuance costs		915,545	969,608
Amortization of discount/premium on long-term debt		27,051,331	26,566,116
Deferred costs expensed in current period		9,726,669	7,841,878
Total nonoperating expenses, net		42,006,776	42,895,834
Change in net position		19,276,986	8,951,214
Total net position, beginning of year		112,408,565	103,457,351
Total net position, end of year	$	131,685,551	112,408,565

See accompanying notes to financial statements.

SOUTHERN MINNESOTA MUNICIPAL POWER AGENCY

Statements of Cash Flows

Years ended December 31, 2017 and 2016

	2017	2016
Cash flows from operating activities:		
Receipts from members	$ 214,395,203	210,387,061
Receipts from others	24,461,333	30,354,211
Payments for fuel	(9,570,485)	(36,335,958)
Payments for other power production	(64,408,686)	(64,202,654)
Payments for other operating expenses	(53,906,502)	(50,922,426)
Payments for maintenance	(8,123,061)	(6,961,803)
Payments in lieu of property taxes	(9,690,117)	(4,634,410)
Net cash provided by operating activities	93,157,685	77,684,021
Cash flows from noncapital financing activity:		
Miscellaneous income	1,225,279	1,223,972
Net cash provided by noncapital financing activity	1,225,279	1,223,972
Cash flows from capital and related financing activities:		
Capital asset additions	(36,232,618)	(33,789,849)
Net payments on notes payable related to commercial paper program	(35,000,000)	—
Net borrowings on notes payable	28,500,000	5,000,000
Proceeds from issuance of revenue bonds	27,932,206	—
Cash paid for bond issuance costs	(456,184)	—
Principal payments for long-term debt	(60,090,000)	(55,695,000)
Interest payments	(10,984,968)	(12,167,878)
Net cash used in capital and related financing activities	(86,331,564)	(96,652,727)
Cash flows from investing activities:		
Proceeds from sale/maturity of investments	139,466,899	356,595,437
Purchase of investments	(149,974,832)	(339,871,265)
Interest received	2,444,955	1,391,175
Escrow deposit	—	(558,614)
Net cash (used in) provided by investing activities	(8,062,978)	17,556,733
Change in cash	(11,578)	(188,001)
Cash, beginning balance	42,533	230,534
Cash, ending balance	$ 30,955	42,533
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	$ 61,283,762	51,847,048
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation and amortization	17,865,024	18,159,671
Deferred costs expensed in current period	8,316,431	6,552,723
Change in deferred credits	(267,182)	6,119,827
Pension	300,548	99,120
Changes in operating assets and liabilities:		
Power sales revenue receivables	(571,833)	(1,415,718)
Fuel stock	7,217,515	(6,847,772)
Material inventory	129,124	(59,137)
Prepaids	334,251	(84,477)
Other current assets	(430,300)	321,311
Accounts payable – power production	1,804,621	1,975,040
Accrued liabilities and other payables	(2,824,276)	1,016,385
Total adjustments	31,873,923	25,836,973
Net cash provided by operating activities	$ 93,157,685	77,684,021
Supplemental disclosure of noncash items:		
Capitalized interest	$ 1,710,097	1,764,042

See accompanying notes to financial statements.

(1) Organization and Significant Accounting Policies

(a) Organization and Operation

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

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

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

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

SMMPA Wisconsin, LLC (the LLC), a blended component unit of the Agency, is undertaking an investment in and owns a 6.5% undivided interest in the Badger Coulee 345 kV transmission project in the state of Wisconsin, which is currently being constructed. The LLC is a public utility in Wisconsin and may own utility assets in that state. Condensed financial information for the LLC has not been presented, as the effects of the LLC are not material to the Agency's financial statements taken as a whole. As of December 31, 2017, the LLC's total assets were approximately $16.5 million, comprised principally construction work in progress.

(b) Basis of Accounting

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

revenue and expenses to future periods in which the revenue is earned or the expenses are recovered through the rate-making process.

(c) Capital Assets

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

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

(d) Deposits and Investments

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

(e) Restricted Investments

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

(f) Power Sales Revenue Receivables

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

(g) Fuel Stock and Material Inventory

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

(h) Compensated Absences

The Agency records a liability for vacation as the benefits accrue to employees. The Agency compensates all employees upon termination for unused vacation. Employees who have been employed by the Agency for at least five consecutive years who are leaving the Agency and who are eligible to retire as defined by the Public Employees Retirement Association (PERA), or the estate of any such employee who dies while employed by the Agency, will receive a contribution to their retirement healthcare savings equal to one-third of the value of their remaining unused sick leave.

(i) Income Taxes

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

(j) Rates

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

(k) Operating Revenue and Expenses

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

(l) Deferred Costs to be Recovered in Future Periods

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

(m) Deferred Credits – Rate Stabilization

The Agency intends for its electric service rates to recover costs, as defined above, of providing power supply services. As part of its rate-making process, the Agency budgets an amount as a contribution to or a distribution from the rate stabilization account. The amount of the contribution to, or distribution from, the rate stabilization account is determined by the amount of revenue needed to meet the 1.10 coverage required by the senior bond resolution. Revenue associated with amounts designated as contributions to the rate stabilization account is deferred and reported as an addition to the deferred credits rate stabilization account on the statements of net position. In the event actual operating expenses exceed the 1.10 coverage required by the senior bond resolution, the Agency has the ability to supplement its operating revenue power sales, through the use of accumulations in its rate stabilization account. Usage of the rate stabilization results in the recognition of additional amounts of operating revenues, power sales, and a corresponding reduction in deferred credits rate stabilization on the statements of net position. The Agency (distributed) contributed $(267,182) and $6,119,827 (from) to its rate stabilization account for the years ended December 31, 2017 and 2016, respectively.

(n) Deferred Gain on Involuntary Conversion of Plant Assets

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

(o) Cash Flows

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

(p) Use of Estimates

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

(q) Recently Issued Accounting Standards

In November 2016, GASB issued Statement No. 83, *Certain Asset Retirement Obligations*. This standard addresses accounting and financial reporting for certain asset retirement obligations (AROs). An ARO is a legally enforceable liability associated with the retirement of a tangible capital asset. GASB No. 83 establishes the criteria for recognition of a liability and corresponding deferred outflow or resources, as well as requiring disclosure of information related to AROs. The provisions of GASB No. 83 are effective for the Agency on January 1, 2019.

In June 2017, GASB issued Statement No. 87, *Leases*. This standard establishes a single model for lease accounting based on the foundational principle that leases are financings of the right to use an underlying asset. As a result, recognition of certain lease assets and liabilities for leases that previously were classified as operating leases and recognized as inflows of resources (revenue) or outflows of resources (expenses) based on the payment provisions of the contract. Under GASB No. 87, a lessee is required to recognize a lease liability and an intangible right-to-use lease asset, and a lessor is required to recognize a lease receivable and a deferred inflow of resources. The provisions of GASB No. 87 are effective for the Agency on January 1, 2020.

(r) Deferred Outflows of Pension Resources

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

(s) Pension Liability

For purposes of measuring the net pension liability, deferred outflows/inflows of resources, and pension expense, information about the fiduciary net position of the PERA and additions to/deductions from PERA's fiduciary net position have been determined on the same basis as they are reported by PERA

except that PERA's fiscal year-end is June 30. For this purpose, plan contributions are recognized as of employer payroll paid dates and benefit payments and refunds are recognized when due and payable in accordance with the benefit terms. Investments are reported at fair value.

(t) Deferred Inflows of Pension Resources

Deferred inflows of pension resources are reported only in the statements of net position and results from actuarial calculations. Deferred inflows of pension resources represent an acquisition of net position that applies to a future period(s) and so will not be recognized as an inflow of resources (revenue) until that time.

(2) Deposits and Investments

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

		2017	2016
Current assets:			
Cash	$	30,955	42,533
Investments:			
Unrestricted funds:			
Revenue and operating funds		29,546,994	31,083,103
Rate stabilization		67,261,002	65,955,166
Other		11,177,961	552,805
Total unrestricted funds		107,985,957	97,591,074
Restricted funds:			
Debt service account		68,993,005	66,304,797
Construction		1,488,873	5,847,453
Debt service reserve		1,821,627	249,432
Total restricted funds		72,303,505	72,401,682
Total current investments		180,320,417	170,035,289
Noncurrent investments:			
Restricted funds:			
Debt service reserve		73,732,265	74,116,710
Total noncurrent investments		73,732,265	74,116,710
Total	$	254,052,682	244,151,999

(a) Deposits

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

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

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

Deposit balances are as follows:

		2017	2016
Carrying amount of cash	$	30,955	42,533
Bank balance		62,025	1,645,441

(b) Investments

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

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

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

- Custodial credit risk – The risk that in the event of a failure of the counterparty to an investment transaction (typically a brokerage firm or financial institution), the Agency would not be able to recover the value of the investment or collateral securities; the Agency's investment policy does not limit the value of investments that may be held by an outside party
- Credit risk – The risk that an issuer or other counterparty to an investment will not fulfill its obligations
- Concentration of credit risk – The risk of loss attributed to the magnitude of the Agency's investment in a single issuer
- Interest rate risk – The risk that changes in interest rates will adversely affect the fair value of an investment

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

Investment security	Total portfolio exposure	Exposure per issuer	Additional restriction
U.S. government obligations	100 %	Unlimited	None
Government-sponsored enterprises	100	Unlimited	Rated AA or better by a nationally recognized bond rating agency
Direct and general obligations of any state of the United States	10	10,000,000	Rated AA or better by a nationally recognized bond rating agency
Bonds, notes, debentures or other evidence of indebtedness issued or guaranteed by any corporation	10	10,000,000	Rated AAA by a nationally recognized bond rating agency and rated AA or better by at least one other nationally recognized bond rating agency
Certificates of deposit (negotiable or nonnegotiable)	10	10,000,000	Exposure will be the lesser of $10,000,000 or 10% of the total of the capital, surplus, and undivided earnings of such bank

Investments are summarized as follows:

	2017		2016	
	Amortized cost	Fair value	Amortized cost	Fair value
Money market funds	$ 90,150,492	90,150,492	85,843,466	85,843,466
U.S. government securities	165,422,837	163,871,235	159,221,930	158,266,000
Total investments	$ 255,573,329	254,021,727	245,065,396	244,109,466

The following table presents the Agency's investment balances at December 31, 2017 and information relating to potential investment risks:

	Interest rate risk		Concentration risk	Credit quality rating		
Investment	Less than 1 year	1–5 Years	Over 5% of portfolio	S&P	Moody's	Carrying value
Government securities:						
Federal Home Loan Bank	$ 993,110	21,745,600	9.0 %	AA+	AAA	$ 22,738,710
Federal Farm Credit Bank	—	7,882,000	3.1	AA+	AAA	7,882,000
Federal Home Loan Mortgage Corporation	6,973,500	14,863,740	8.6	AA+	AAA	21,837,240
Federal National Mortgage Association	3,997,840	63,559,055	26.6	AA+	AAA	67,556,895
Federal Home Loan Bank Discount notes	5,985,240	—	2.4	A-1+	P-1	5,985,240
U.S. Treasury note	6,100,000	31,771,150	14.9	AA+	AAA	37,871,150
Cash management funds:						
Wells Fargo Advantage Treasury Plus Money Market	90,150,492	—	N/A	N/R	N/R	90,150,492
						$ 254,021,727

N/A Not applicable
N/R Not rated

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

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

N/A Not applicable
N/R Not rated

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

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

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

At December 31, 2017, the Agency had the following recurring fair value measurements:

Investments by fair value level	December 31, 2017	Fair value measurements using Level 1	Level 2	Level 3
Government securities:				
Federal Home Loan Bank	$ 22,738,710	—	22,738,710	—
Federal Farm Credit Bank	7,882,000	—	7,882,000	—
Federal Home Loan Mortgage Corporation	21,837,240	—	21,837,240	—
Federal National Mortgage Association	67,556,895	—	67,556,895	—
Federal Home Loan discount notes	5,985,240	—	5,985,240	—
U.S. Treasury note	37,871,150	—	37,871,150	
Total government securities	163,871,235	—	163,871,235	—
Cash management funds:				
Wells Fargo Advantage Treasury Plus Money Market	90,150,492	90,150,492	—	—
Total investments by fair value level	$ 254,021,727	90,150,492	163,871,235	—

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

Investments by fair value level	December 31, 2016	Fair value measurements using Level 1	Level 2	Level 3
Government securities:				
Federal Home Loan Bank	$ 20,834,980	—	20,834,980	—
Federal Farm Credit Bank	6,903,360	—	6,903,360	—
Federal Home Loan Mortgage Corporation	11,898,440	—	11,898,440	—
Federal National Mortgage Association	62,641,730	—	62,641,730	—
Federal Home Loan discount notes	9,996,080	—	9,996,080	—
U.S. Treasury note	32,001,780	—	32,001,780	—
U.S. Treasury bill	13,989,630	—	13,989,630	—
Total government securities	158,266,000	—	158,266,000	—
Cash management funds:				
Wells Fargo Advantage Treasury Plus Money Market	85,843,466	85,843,466	—	—
Total investments by fair value level	$ 244,109,466	85,843,466	158,266,000	—

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

- U.S. Treasuries, U.S. agencies, and commercial paper: Quoted prices for identical securities in markets that are not active
- Corporate and Municipal Bonds: Quoted prices for similar securities in active markets
- Repurchase agreements, negotiable certificates of deposit, and collateralized debt obligations: Matrix pricing based on the securities' relationship to benchmark quoted prices
- Money market, bond, and equity mutual funds: Published fair value per share (unit) for each fund

(3) Capital Assets

Capital asset activity was as follows:

2017	Beginning balance	Additions	Transfers	Retirements	Ending balance
Nondepreciable:					
Land and land rights	$ 6,304,758	—	—	—	6,304,758
Construction work in progress	50,252,596	36,414,126	(1,667,551)	—	84,999,171
Depreciable:					
Utility plant in service	817,992,417	1,528,589	1,667,551	(506,848)	820,681,709
Less accumulated depreciation for utility plant in service	(371,696,808)	(21,120,014)	—	506,848	(392,309,974)
Capital assets, net	$ 502,852,963	16,822,701	—	—	519,675,664

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

(4) Long-Term Debt

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

	2017	2016
Series 2002A, 2.00%–5.25%, due January 1, 2004 to 2018	$ —	50,165,000
Series 2006A, 3.65%–4.25%, due January 1, 2011 to 2027	5,030,000	10,060,000
Series 2009A, 2.00%–5.50%, due January 1, 2011 to 2030	8,025,000	10,495,000
Taxable Series 2010A (Build America Bonds), 3.774%–5.926%, due January 1, 2018 to 2043	67,990,000	67,990,000
Series 2010B (Tax-Exempt), 2.00%–4.00%, due January 1, 2013 to 2017	—	1,640,000
Series 2015A, 2.00%–5.00%, due January 1, 2016 to 2046	96,890,000	97,675,000
Series 2017A, 3.00%–5.00%, due January 1, 2017 to 2047	23,810,000	—
	201,745,000	238,025,000
Less unamortized discount/premium	(17,427,440)	(17,088,778)
	219,172,440	255,113,778
Series 1994A, 6.65%–6.70%, CABs due January 1, 2019 to 2027	503,300,000	503,300,000
Series 2002A, 4.65%, CABs due January 1, 2018	55,320,000	55,320,000
	558,620,000	558,620,000
Less unamortized discount	132,297,807	158,376,720
	426,322,193	400,243,280
	645,494,633	655,357,058
Less current maturities	63,875,000	60,090,000
	$ 581,619,633	595,267,058

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

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

During 2017, the Agency issued $23,810,000 in tax-exempt Power Supply Revenue Bonds, Series 2017A at par value. An additional premium of $4,122,206 and other sources of funds resulted in total sources of funds for the issuance of $27,932,206. The proceeds were used for the primary purpose of providing funds for the payment of loans made under the revolving credit agreement, the proceeds of which have been used to finance the construction of the Owatonna Energy Station generating facility. Revenue bond debt service requirements to maturity are as follows:

	Principal	Interest
2018	$ 63,875,000	9,165,921
2019	65,440,000	9,744,364
2020	65,615,000	9,445,023
2021	65,845,000	9,133,339
2022	66,155,000	8,796,081
2023–2027	313,870,000	38,180,091
2028–2032	35,135,000	27,635,008
2033–2037	27,820,000	19,864,613
2038–2042	34,505,000	11,542,444
2043–2047	22,105,000	2,738,151
	$ 760,365,000	146,245,035

Long-term liability activity for the year ended December 31, 2017 was as follows:

2017	Beginning balance	Additions	Reductions	Ending balance
Long-term revenue bonds	$ 796,645,000	23,810,000	(60,090,000)	760,365,000
Less:				
Current maturities	(60,090,000)	(3,785,000)	—	(63,875,000)
Unamortized discount, net	(141,287,942)	—	26,417,575	(114,870,367)
Long-term revenue bonds, net	$ 595,267,058	20,025,000	(33,672,425)	581,619,633
Derivative instruments – swap liability	$ 182,480	—	(137,952)	44,528
Pension liability	6,519,962	—	(1,323,440)	5,196,522

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

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

(5) Notes Payable

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

Commercial Paper Notes, Series B activity for the years ended December 31, 2017 and 2016 was as follows:

Activity for fiscal year		Beginning balance	Issues	Maturities	Ending balance
2017	$	35,000,000	29,900,000	(64,900,000)	—
2016		35,000,000	526,700,000	(526,700,000)	35,000,000

The Agency entered into a Revolving Credit Agreement (RCA) with U.S. Bank on January 11, 2017. The RCA replaces the Agency's $68.0 million commercial paper program. The RCA is a U.S. Bank variable-rate, short-term program with a 3.5-year term with an option to extend the agreement. The financing is in the form of advances made by U.S. Bank to the Agency up to a maximum program size. Interest on the advanced funds is based on the one-month LIBOR index adjusted to reflect the Agency's tax-exempt status, plus an applicable spread. The RCA bears interest at the index rate so long as no event of taxability or event of default (as defined in the agreement) has occurred. The RCA also incurs a fee on the unused portion. RCA activity for the year ended December 31, 2017 was as follows:

Activity for fiscal year		Beginning balance	Additions	Reductions	Ending balance
2017	$	—	45,700,000	(26,200,000)	19,500,000

The Agency entered into a Continuing Covenants Agreement (CCA), Southern Minnesota Municipal Power Agency Badger Coulee Project Revenue Bonds, 2016 Series A, with U.S. Bank on May 25, 2016. The CCA allows U.S. Bank to provide short-term construction financing for the Badger Coulee transmission project up to $35,000,000 with a three-year term with an option to extend the agreement. The financing is in the form of a loan made by U.S. Bank as a condition of the Agency issuing variable-rate bonds, which are then purchased directly by the bank. The notes shall bear interest at a per annum rate of interest based on the index rate applied to a tax-exempt factor plus an applicable spread. The bank index is based on the one-month LIBOR. The notes shall bear interest at the index rate so long as no event of taxability or event of default has occurred. There is a fee on the unused portion of the program.

Badger Coulee Project Revenue Bonds, 2016 Series A activity for the years ended December 31, 2017 and 2016 was as follows:

Activity for fiscal year	Beginning balance	Additions	Reductions	Ending balance
2017	$ 5,000,000	9,000,000	—	14,000,000
2016	—	5,000,000	—	5,000,000

(6) Derivative Instruments

The Agency applies GASB Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*. The tables below summarize derivative instrument activity for the years ended December 31, 2017 and 2016 and balances at end of 2017 and 2016:

	Changes in fair value for year ended December 31, 2017		Fair value at December 31, 2017		Notional amount
	Classification	Amount	Classification	Amount	
Cash flow hedges:					
Pay-fixed interest rate swaps	Deferred outflow	$ (137,952)	Long-term liabilities	$ (44,528)	5,030,000

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

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

(a) Objectives

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

(b) Terms

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

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

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

(c) Credit Risk

Credit risk can be measured by actual market value exposure or theoretical exposure. When the fair value of any swap has a positive market value, then the Agency is exposed to the actual risk that the counterparty will not fulfill its obligations. As of December 31, 2017, the Agency had no net exposure to actual credit risk on its hedging derivatives because each had a negative fair value.

(d) Interest Rate Risk

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

(e) Basis Risk

The Agency is exposed to basis risk when the variable interest received on a swap is based on a different index than the variable-interest rate to be paid on the associated variable-rate debt obligation. As of December 31, 2017, the associated debt used the same index for all consumer price index (CPI) referenced swaps. As a result, there is no significant exposure to basis risk as of December 31, 2017.

(f) Termination Risk

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

(g) Rollover Risk

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

(h) Foreign Currency Risk

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

(7) Pension Plan

(a) Plan Description

The Agency participates in the General Employees Retirement Plan, which is a cost-sharing, multiple-employer, defined-benefit pension plan administered by 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.

All full-time and certain part-time employees of the Agency are covered by the General Employees Plan (accounted for in the General Employees Fund). 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. 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 90.0% funded for two consecutive years are given 2.5% increases. Members in plans that have not exceeded 90.0% funded, or have fallen below 80.0%, are given 1% increases.

General Employees Plan benefits are based on a member's highest average salary for any 5 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 Plan 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 10 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 10 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. The benefit provisions stated in the previous paragraphs of this section are current provisions and apply to active plan participants. Vested, terminated employees who are entitled to benefits but are not receiving them yet are bound by the provisions in effect at the time they last terminated their public service.

(b) Funding Policy

Minnesota Statutes Chapter 353 sets the rates for employer and employee contributions. Contribution rates can only be modified by the state legislature. The Agency makes annual contributions to the pension plans equal to the amount required by Chapter 353 of the state statutes. Basic Plan members and Coordinated Plan members were required to contribute 9.10% and 6.50%, respectively, of their annual covered salary in calendar year 2017. The Agency was required to contribute 11.78% of pay for Basic Plan members and 7.50% for Coordinated Plan members in calendar year 2017. The Agency's contributions to General Employees Fund for the years ended December 31, 2017 and 2016 were $409,919 and $379,596, respectively. The Agency's contributions were equal to the contractually required contributions for both years as set by the statute. The Agency's employees are all Coordinated Plan members.

(c) Pension Costs

The Agency reported a liability of $5,196,522 and $6,519,962 at December 31, 2017 and 2016, respectively, for its proportionate share of the General Employees Fund'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 overall General Employees Fund in 2017 and 2016. The State of Minnesota is considered a nonemployer 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 $65,359 for 2017 and $85,102 for 2016. The net pension liability was measured as of June 30 for each respective year, and the total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of that date. The Agency's proportion of the net pension liability was based on the Agency's contributions received by PERA during the measurement period for employer payroll paid dates from July 1 through June 30 for each respective year relative to the total employer contributions received from all of PERA's participating employers. At June 30, 2017, the Agency's proportionate share was 0.0814%, which was an increase of 0.0011% from its proportion measured as of June 30, 2016 of 0.0803%.

For the years ended December 31, 2017 and 2016, the Agency recognized pension expense of $321,478 and $440,970, respectively, for its proportionate share of General Employees Plan's pension expense. In addition, the Agency recognized an additional $1,888 in 2017 and $25,375 in 2016 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.

At December 31, 2017, the Agency reported its proportionate share of General Employees Plan's deferred outflows of resources and deferred inflows of resources, and its contributions subsequent to the measurement date, from the following sources:

	2017		2016	
	Deferred outflows of resources	Deferred inflows of resources	Deferred outflows of resources	Deferred inflows of resources
Differences between expected and actual economic experience	$ 171,262	333,533	22,157	537,141
Changes in actuarial assumptions	851,076	520,952	1,411,311	—
Net difference between projected and actual earnings on plan investments	—	236,714	1,253,339	536,896
Change in proportion	66,986	214,223	—	372,736
Contributions paid to PERA subsequent to the measurement date	206,875	—	374,731	—
	$ 1,296,199	1,305,422	3,061,538	1,446,773

Deferred outflows of resources related to pensions resulting from the Agency's contributions subsequent to the measurement date in the amount of $206,875 were reported and 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 inflows of resources related to pensions will be recognized in pension expense as follows:

2018	$ (180,570)
2019	264,359
2020	(79,306)
2021	(220,581)
	$ (216,098)

(d) Actuarial Assumptions

The total pension liability in the June 30, 2017 and 2016 actuarial valuations was determined using the following actuarial assumptions:

	2017	2016
Inflation	2.50% Per year	2.50% Per year
Active member payroll growth	3.25% Per year	3.25% Per year
Investment rate of return	7.50 %	7.50 %

Salary increases were based on a service-related table. Mortality rates for active members, retirees, survivors, and disabled participants were based on RP 2014 tables for males or females, as appropriate, with slight adjustments. Cost-of-living benefit increases for retirees are assumed to be 1.0% effective every January 1 until 2044, then 2.5% for the General Employees Plan.

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 60.0% for vested and nonvested 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 nonvested deferred member liability.
- The assumed postretirement 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:

	Target allocation	Expected real rate of return
Asset class:		
Domestic stocks	39.00 %	5.10 %
International stocks	19.00	5.30
Bonds	20.00	0.75
Alternative assets	20.00	5.90
Cash	2.00	—
Total	100.00 %	

(e) Discount Rate

The discount rate used to measure the total pension liability was 7.5% in 2017 and 2016. 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.

(f) Pension Liability Sensitivity

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

	Agency proportionate share of net pension liability		
	1% Decrease (6.50%)	Current (7.50%)	1% Increase (8.50%)
Year ended:			
December 31, 2017	$ 8,060,192	5,196,522	2,858,088
December 31, 2016	9,260,278	6,519,962	4,262,687

(g) Pension Plan Fiduciary Net Position

Detailed information about the General Employees Retirement 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 at www.mnpera.org.

(8) Deferred Compensation Plans

The Agency offers its employees a deferred compensation plan created in accordance with Internal Revenue Code Section 457. The plan, available to all Agency employees, permits them to defer a portion of their salary until future years. The deferred compensation is not available to employees until termination, retirement, death, or unforeseeable emergency. All assets and income of the plan are held in a trust established for the exclusive benefit of eligible employees and their beneficiaries in accordance with Internal Revenue Code Section 457(g). Participants' rights under the plan are equal to the fair market value of the deferred account for each participant. The trust shall not revert to the Agency or be used for or diverted to purposes other than the exclusive benefit of participants and their beneficiaries. The plan is managed by third-party administrators. Plan assets were $14,736,128 and $12,577,428 at December 31, 2017 and 2016, respectively. The Agency contributed $118,706 and $99,793 to the plan for the years ended December 31, 2017 and 2016, respectively.

The Agency also offers a tax-qualified, defined-contribution plan created in accordance with Internal Revenue Code Section 401(a). The plan, available to all Agency employees with six months of continuous service, permits them to defer a portion of their salary until future years. The amount deferred is not available to employees until termination, retirement, death, or unforeseeable emergency. Participants' rights under the plan are equal to the fair market value of the account for each participant. The plan is managed by third-party administrators. Plan assets were $2,847,386 and $2,189,760 at December 31, 2017 and 2016, respectively. The Agency contributed $248,012 and $221,654 to the plan for the years ended December 31, 2017 and 2016, respectively.

(9) Risk Management

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

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

(10) Contingencies

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

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

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

SOUTHERN MINNESOTA MUNICIPAL POWER AGENCY

Required Supplementary Information (Unaudited)

December 31, 2017

Schedule of Agency's Proportionate Share of Net Pension Liability and Related Ratios as of Measurement Date
PERA General Employees Retirement Fund
Cost-Sharing, Multiple-Employer Defined-Benefit Pension Plans (Last 10 Fiscal Years*)

Fiscal year ended (for the measurement period)	Employer's proportion (percentage) of the net pension liability (asset)	Employer's proportionate share (amount) of the net pension liability (asset) (a)	State's proportionate share (amount) of the net pension liability associated with the Agency (b)	Employer's proportionate share of the net pension liability and the State's proportionate share (amount) of the net pension liability associated with the Agency (a+b)	Employer's covered-employee payroll (c)	Employer's proportionate share of the net pension liability (asset) as a percentage of its covered-employee payroll (a+b)/(c)	Plan fiduciary net position as a percentage of the total pension liability
June 30, 2017	0.0814 %	$ 5,196,522	65,359	5,261,881	5,465,584	96.27 %	75.90 %
June 30, 2016	0.0803	6,519,962	85,102	6,605,064	5,061,274	130.50 %	68.91 %

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

See accompanying independent auditors' report.

SOUTHERN MINNESOTA MUNICIPAL POWER AGENCY

Required Supplementary Information (Unaudited)

December 31, 2017

Schedule of Agency's Contributions
PERA General Employees Retirement Fund
Cost-Sharing, Multiple-Employer Defined Benefit Pension Plans (Last 10 Fiscal Years*)

Fiscal year ended (for the financial reporting period)	Statutorily required contribution (a)	Contributions in relation to the statutorily required contribution (b)	Contribution deficiency (excess) (a-b)	Covered-employee payroll (d)	Contributions as a percentage of covered-employee payroll (b/d)
December 31, 2017	$ 409,919	409,919	—	5,465,584	7.50 %
December 31, 2016	379,596	379,596	—	5,061,274	7.50

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

See accompanying independent auditors' report.