

WORKING FOR YOU

PEDERNALES ELECTRIC COOPERATIVE
2015 ANNUAL REPORT





A MESSAGE FROM BOARD PRESIDENT JAMES OAKLEY

I'm a fifth-generation Burnet native who, through various public offices over the years, has devoted my life to serving the beautiful Texas Hill Country and the warm people who make up its communities. Over the past century, Central Texans have shown extraordinary grit in transforming a harsh landscape of rock, thorn and sting into one of the most desirable areas in the country, and since 1938, Pedernales Electric Cooperative has been an important part of that success story.

Today, PEC is the largest electric distribution cooperative in the U.S., and it grew by nearly 4 percent in 2015, putting the Co-op at 275,282 meters by year's end. With new homes and businesses being added every day, the Hill Country is rapidly evolving, and PEC is evolving with it.

With our region's exceptional growth, it's important to strike a balance between welcoming change and preserving the natural beauty of this region. I was honored to be able to lead a 2015 realignment of the Co-op's Board districts as well as the adoption of a new PEC Strategic Plan. This document outlines the Co-op's objectives through 2017, including the goal to meet or exceed, in the Co-op's energy mix, the ERCOT or national average in renewable power. From there, the Co-op has been developing viable,

non-subsidized renewable energy programs, some of which launched last year. I'm especially pleased that we've committed to pursue this in a cost-effective way, reducing costs and rates to members even as the amount of renewable energy in our mix increases.

PEC takes pride in being an organization its members know will be there for them. When historic flooding over the 2015 Memorial Day weekend devastated communities along the Blanco River, the team went above and beyond by clearing debris, towing cars from creek beds, distributing drinking water and taking up collections for those affected by the tragedy. Throughout these efforts, we weren't just serving customers; we were helping our friends and neighbors get back on their feet.

Projections tell us that the Hill Country's development won't slow down anytime soon. We expect astounding growth in the next 20 years and a PEC meter count that will continually reach new heights. The Hill Country's success story isn't over, and the Cooperative stands ready for the future, whatever it may bring.



A MESSAGE FROM CEO JOHN HEWA

PEC promised lower rates for its members, and last year, we delivered. After an initial rate reduction in December 2014, the power cost adjustment was lowered three times in 2015, saving the typical PEC account more than \$160 annually. In addition, the Co-op came in \$2 million under budget. To return every extra dollar to members as quickly as possible, we developed the Revenue Adjustment Factor, which was activated temporarily to reduce the revenue collected through members' bills. By offering resources and a rejuvenated free home energy audit program, we're also showing members how they can save even more by conserving electricity.

What's remarkable is that despite 2015's lower rates, higher meter count and reduced staffing level (one not seen at the Co-op since 2002, when it had about 100,000 fewer meters), PEC members got more for their money. Modern technologies were put into place in nearly every area of the organization, including a new enterprise software system, online portal, mobile app and interactive voice response phone system. These systems, along with streamlined processes and upgraded equipment, have allowed Co-op staff to work even smarter, offering members more convenient self-service options than ever before.

As a series of severe weather events struck the Hill Country last year, PEC linemen struck back. During the Memorial Day weekend floods in particular, crews put forth a tremendous effort, restoring power to more than 27,650 meters in two days. By day four, even the most damaged region along the Blanco River had power restored.

Office employees were no less dedicated last year as they supported some of the Co-op's chief 2015 achievements, such as a comprehensive system inventory, the launch of the Empower Loans program and work that is laying the foundation for a community solar program expected later this year.

PEC has always been a strong local employer recognized with great employees, and it will continue to recruit the region's best and brightest, people who can keep the Co-op at the forefront of the rapidly changing electric industry. Along the way, we won't lose our sense of small-town community and service. Whether you're an early adopter of the newest tech or prefer doing business in a more traditional way, every day PEC is serving you better than the day before. We're your Cooperative, and we're working for YOU.

231,641
Members

275,282
Active Accounts

21,613
Miles of Line

10,000+
Added Meters

\$589.6M
Annual Revenue

697
Employees

8,100
Square Miles in
PEC's Service Territory



WORKING SMART

Because PEC is a not-for-profit cooperative, when the Co-op saves so do you. By implementing new technologies, centralizing departments, streamlining processes and reducing controllable costs, the Co-op worked even smarter last year to bring more value to its growing membership without sacrificing quality.

The implementation of a new enterprise software system improved efficiencies for staff while delivering more features to members, including a new online portal, a mobile app and an interactive voice response phone system. The Co-op also invested in new high-tech tools, such as an automated vehicle locator system and radio frequency and ultrasonic line scanners.

All these new efficiencies paid off as PEC held fast to a promise to reduce rates despite tremendous regional development and the implementation of new systems. After an initial rate reduction in 2014, three power cost reductions went into effect in 2015, saving the typical PEC account more than \$160 annually. More savings were realized through the Co-op's innovative new Revenue Adjustment Factor. This temporary reduction kept an approximately \$2 million end-of-year budget surplus in members' pockets, an average of about \$7 of additional savings per account.

When your Cooperative works more efficiently, it doesn't only save you money, it saves you time. It means faster service and better electric reliability, and it's changing the way members do business with us. You can now pay your bill on the go through one of our drive-through kiosks or the SmartHub mobile app, request tree trimming via PEC's new online portal or report a power outage instantly on your tablet. Getting more features for less money doesn't happen with most companies, but PEC isn't like most companies — we're working for YOU.



"Belinda showed me how I can track my electric use with the SmartHub app. I'm so glad she told me about the discounts for paperless billing and bank draft payments. I love saving money!"

GRETCHEN SANDERS
PEC MEMBER

"I take pride in providing excellent service online and in person. With PEC's new systems in place, I can spend more one-on-one time with members who have questions. Once we start talking, it doesn't feel like work!"

BELINDA CRESWELL
PEC MEMBER SERVICES WEB SUPPORT

\$160.68

Annual Savings for
Typical Account
(Jan. '15 - Dec. '15)

\$15M+

Bond Refinancing
Savings Through 2020

\$1.2M

New Mobile Refueling
Program Projected Annual
Savings

\$1M

Annual Savings on Parts and
Labor Through New Fleet
Maintenance Program

\$2M

Reduction in Members'
Bills through Revenue
Adjustment Factor Credit

\$1.4M

Annual Revenue Recovered
in Commercial Meter
Inspection Program

700

Miles of Line Scanned
for Efficiency with
Radio Frequency Equipment



HERE FOR YOU

PEC is your cooperative, and we want you to feel it throughout every interaction. In 2015, the Co-op once again rated in the top quartile of all electric utilities in customer satisfaction, and service levels remained high, even in a year when a leaner workforce was coming up to speed on new technologies and programs.

You've never had so much information about your Cooperative at your fingertips. The new SmartHub online portal and app host a wealth of data about your account and electric use, and a new member newsletter, *PEC Current*, is included with every bill. In addition, the Co-op has been active online via *Energy News* as well as Facebook and Twitter.

True service, however, comes from the heart. During 2015's Memorial Day weekend floods, PEC crews worked around the clock to restore power as quickly as possible. We met with tough challenges, but mobilized into an army of brute strength, using technology and innovative problem solving to restore power to more than 27,650 meters over the course of two days. By day four, all Co-op power was back up, even in the worst-hit region along the Blanco River.

Off the clock, PEC employees supported storm-ravaged communities through many small kindnesses, such as distributing drinking water and taking up collections for flood victims. Since its founding, the Co-op has exemplified the cooperative principle of concern for community, and our employees embody that spirit of giving.

PEC has long been a supporter of local nonprofits, and in 2015 we had the opportunity to reach farther and bring our story full circle. In February, a Co-op line crew was dispatched to Haiti to help the people there electrify three rural villages. When the lights came on for the first time, we knew we'd made their lives a little brighter, just as PEC's founders continue to brighten ours.



"We are so thankful for how quickly PEC came to the rescue. When volunteers could get to our home, they came in droves. Without electricity, they wouldn't have been able to start so quickly with the cleanup. ... Electricity was such a blessing."

BILL AND DIANNE FOJTASEK
PEC MEMBERS WHOSE HOME FLOODED DURING MEMORIAL DAY WEEKEND

"I was speechless when I saw the destruction but knew the PEC team would not stop working until we got the power back on to everyone that was affected. We helped the best way we knew how — giving them hope by restoring their power."

TERRY KIRCUS
PEC CONSTRUCTION/SERVICE SUPERVISOR



TOP 25%

of All U.S. Electric Co-ops in Overall Customer Satisfaction

\$8.1M

in Capital Credits Distributed To Members

27,650+

Meters Restored in Two Days After Memorial Day Weekend Floods

1.8M+

Contacts With Members Via Phone, Online and in Offices

7,900+

Members Responded to PEC Cost-of-Service and Rate Surveys

632

Organizations Received Monetary Support From PEC

6,000

Typical Monthly SmartHub App Payments



RELIABLE, RESPONSIBLE POWER

PEC has a long tradition of renowned reliability, and 2015 was no different. The Cooperative maintained a reliability score in the top 20 percent nationally last year among 813 electric cooperatives. We accomplished this while facing a series of challenging weather events, including historic rainstorms and flooding over Memorial Day weekend.

This kind of performance doesn't come about by chance. It's a result of PEC's dedicated workforce and sustained investment in the strength of its distribution system. Last year, we once again kept ahead of area development by upgrading equipment to meet rising electric demand and anticipating potential issues through regular inspections. Reliability is strengthening, in part due to new efficiencies, new tools and the 2015 completion of a comprehensive system inventory, which led to precise mapping of the more than 500,000 pieces of equipment that make up the Co-op's grid.

But delivering power in this day and age is about more than keeping the lights on; it's about empowering YOU. While the Co-op will continue to rely upon a balanced portfolio of low-cost resources for the bulk of its energy needs, innovative technologies are enabling a growing number of new options that could help lower costs, increase diversity and provide you with more choices. Last year, staff completed an integrated resource plan with the input of members to determine what the Co-op's future energy mix should look like. We also initiated the Empower Loans program and adopted a landmark resolution to add 15 megawatts of distributed solar power to PEC's energy mix.

The Co-op updated its existing renewable energy and conservation programs as well last year, including a new energy audit program, a revised interconnection process and HVAC and commercial lighting rebates. We're working hard every day to help you achieve your energy goals. How's that for service?



"I have enjoyed working with PEC and being on the Hill Country Solar Tour in 2014. They are a great example of how a Co-op can and should work with their members who want to add solar to their home or business."

JOHN GARDNER
PEC MEMBER

"PEC is committed to creating a balanced power portfolio, incorporating renewable energy in a well considered, cost-effective way to offer members more options when it comes to meeting their personal energy goals."

BLAKE BEAVERS
PEC RENEWABLE & DISTRIBUTED
ENERGY MANAGER

TOP 20%

Reliability Nationally Among
Electric Cooperatives Per CFC's
Key Ratio Trend Analysis

5,505,843MWH

Total Billed Megawatt-
Hours of Power

7.7%

Renewable Power
Distributed in PEC's
Total Energy Mix

961

Total PEC Renewable
Generation Interconnections

375

New Renewable
Generation Interconnections

7KW

Co-op's Average
Residential
Solar Installation

53%

Power Generated from
Natural Gas in the
Co-op's Energy Mix



PEC BOARD OF DIRECTORS



Cristi Clement
District 1 Director



Kathryn Scanlon
District 3 Director



Chris Perry
District 4 Director



James Oakley
District 5 Director
President



Paul Graf
District 6 Director
Secretary-Treasurer



Amy Lea SJ Akers
District 7 Director



Emily Pataki
District 2 Director
Vice President

A MESSAGE FROM VICE PRESIDENT EMILY PATAKI

The list of PEC's achievements for 2015 is astounding. Many of these successes increased efficiencies and reduced controllable costs, and further investments are expected to result in savings down the line. Additionally, the cost reductions put in place the past two years leave PEC's rates lower than the Texas and national averages, and there's more to come. The Hill Country's future can only grow brighter!



Since 1938, Pedernales Electric Cooperative has served its members, supported its communities and helped extend electric service throughout the Texas Hill Country. As a PEC member, you are an owner of this organization, its history and its future.



PEDERNALES ELECTRIC COOPERATIVE

pec.coop

PEDERNALES ELECTRIC COOPERATIVE



2015 NOTABLE ACHIEVEMENTS



Overall

- Added more than 10,000 new meters as one of the fastest growing cooperatives in the U.S.
- Efficiencies created in every department
- In addition to a December 2014 rate reduction, the power cost adjustment was lowered three times in 2015, saving the typical account an additional \$160 per year and securing PEC's rates lower than the Texas and national averages
- Implemented more convenient options for our members, including a new enterprise software system, online portal, mobile app and interactive voice response phone system
- Restored power to more than 27,650 meters in two days after historic Memorial Day weekend flooding
- Participated in the NRECA International program by sending a three-man line crew to help electrify three villages in rural Haiti

Governance

- Board adopted a 2015-2017 PEC Strategic Plan
- Realigned PEC Board districts
- Successful democratic 2015 election and annual meeting with 97 percent online voting satisfaction
- Recommitted to ethics and transparency through new Ethics & Compliance Program

Financial

- 2015 unqualified audit with no negative management letter comments
- Implemented revenue and financial forecast with accuracy
- Distributed \$8.1 million in capital credits to members
- Created Revenue Adjustment Factor to leave \$2 million in members' pockets

- Refinanced \$78 million in previously issued bonds at a lower interest rate to save the Co-op more than \$15 million through 2020
- Reduced controllable expenses by \$2.19 million using proper budgeting processes
- Evaluated Rural Utilities Service loan opportunities and will continue to look for new ways to lower the cost of debt
- Implemented equity management plan and improved equity as a percent of assets to 37 percent
- Completed cost-of-service and rate study with the participation of more than 7,900 members

Systems

- 113,000 registrations on new online portal
- 250 payments per day via new mobile app
- 1,500 calls per day through new interactive voice response phone system
- Processed 585,656 online payments totaling more than \$102 million
- New mobile power outage reporting
- New scanners expedite bill handling
- More flexible billing options
- Dynamic notifications
- Enhanced security

Reliability

- Maintained reliability scores in the top 20 percent nationally among 813 electric cooperatives (according to National Rural Utilities Cooperative Finance Corporation's 2014 Key Ratio Trend Analysis)
- Completed comprehensive system inventory of more than 500,000 nodes of the Co-op's electric distribution system
- Completed 49 Capital Improvement Projects and

CONTINUED



2015 NOTABLE ACHIEVEMENTS (CONTINUED FROM FRONT)

- 70 voltage conversion upgrades improving service to about 215,000 meters
- More than 9,000 line extensions constructed and \$36 million in materials issued
- Proactive maintenance programs: underground service vegetation maintenance, underground service aged infrastructure rehabilitation, pole test and treat replacement, feeder construction and rehabilitation
- Aerial inspection program covered 17,703 Junction-area poles in 10 days
- Completed distribution fault anticipator project with Texas A&M
- Proactively identified and corrected 122 equipment issues through airborne ultrasonic scanning

Service

- Top 25 percent of all electric utilities in overall satisfaction
- More than 1.8 million member contacts
- More than 682,000 total calls handled
- New flexibilities for payment and self service
- More information than ever before at pec.coop
- New *PEC Current* bill insert newsletter
- Serving more members through social media with 62 percent more Facebook likes and 42 percent more Twitter followers

Engineering

- Fully implemented Automated Vehicle Locator system
- New mobile refueling program with projected savings of \$1.2 million per year and fuel cost savings of \$600,000 per year
- More than \$1.4 million annual revenue recovered through commercial meter inspection program
- Launched fleet maintenance program, saving more than \$1 million per year on parts and labor
- New centralized vegetation program delivering 10 percent cost savings
- Implemented grid-optimization programs that saved the Co-op money through the use of new technologies and improved electric line efficiency
- Volt-VAR optimization program deployed to reduce transmission costs, which make up approximately 10 percent of PEC's rates

Conservation & Renewable Power

- Added 375 new member interconnections for a year-end total of 961
- Completed the Integrated Resource Plan study
- Adopted a landmark resolution to add 15 megawatts of distributed solar energy to the Co-op's power mix

- Evaluated and prepared a forthcoming community solar program
- Initiated the Empower Loans program
- Streamlined the interconnections process
- Introduced the Honeywell Energy Platform audit tool for use with free home energy audits
- Executed an incentive program for HVAC and commercial lighting
- Voltage optimization for demand-side management
- Expanded energy information and alerts

Safety

- Published first in-house PEC safety manual
- Began Rural Electric Safety Achievement Program initial scouting and inspection
- Realized significant improvement in safety performance with a 39 percent improvement (over 2014) in Total Case Incident Rate
- A more engaged safety culture resulted in a 73 percent improvement (over 2014) in Days Away Restricted Time
- Decreased vehicle accidents by 45 percent over 2014 performance
- Hired Director of Safety with expanded oversight for PEC security
- Created Security Manager role for Cooperative-wide emphasis on people and facilities

Employees

- Reduced headcount through attrition to fewer than 700 employees (matching 2002 staffing level, when PEC served 100,000 fewer accounts)
- Increased employee engagement and job satisfaction
- Improved organizational policies, procedures and processes
- Recruited and retained key positions to serve member growth and expectations
- Improved field computing power and connectivity
- Saved time through the activation of automated work order routing
- Launched a Cooperative internship program
- Successful continuation and recognition of Department of Labor Apprenticeship Program with successful transition and alignment to the Northwest Lineman College Apprenticeship curriculum
- Created additional employee engagement opportunities through the PEC Volunteerism Program
- Participation in the Texas and National Lineman's Rodeos

PEDERNALES ELECTRIC COOPERATIVE

2015 FINANCIAL REPORT



PEDERNALES ELECTRIC COOPERATIVE, INC.

JOHNSON CITY, TEXAS

FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2015 AND 2014

AND

REPORT OF CERTIFIED PUBLIC ACCOUNTANTS

PEDERNALES ELECTRIC COOPERATIVE, INC.
JOHNSON CITY, TEXAS

FINANCIAL STATEMENTS
FOR THE YEARS ENDED DECEMBER 31, 2015 AND 2014

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BOLINGER, SEGARS, GILBERT & MOSS, L.L.P.

CERTIFIED PUBLIC ACCOUNTANTS

PHONE: (806) 747-3806

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8215 NASHVILLE AVENUE

LUBBOCK, TEXAS 79423-1954

Independent Auditor's Report

Board of Directors
Pedernales Electric Cooperative, Inc.
Johnson City, Texas

We have audited the accompanying financial statements of Pedernales Electric Cooperative, Inc. (the Cooperative), which comprise the balance sheets as of December 31, 2015 and 2014, and the related statements of income and patronage capital and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit 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 auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Pedernales Electric Cooperative, Inc. as of December 31, 2015 and 2014, and the results of their operations and cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Bolinger, Segars, Gilbert & Moss LLP

Certified Public Accountants

Lubbock, Texas

April 7, 2016

PEDERNALES ELECTRIC COOPERATIVE, INC.

BALANCE SHEETS
DECEMBER 31, 2015 AND 2014

ASSETS

	December 31,	
	2015	2014
UTILITY PLANT AT COST		
Utility Plant in Service	\$ 1,487,807,894	\$ 1,443,552,804
Construction Work in Progress	61,833,058	53,561,428
	<u>\$ 1,549,640,952</u>	<u>\$ 1,497,114,232</u>
Less: Accumulated Provision for Depreciation	293,745,821	299,040,123
	<u>\$ 1,255,895,131</u>	<u>\$ 1,198,074,109</u>
OTHER PROPERTY AND INVESTMENTS - AT COST OR STATED VALUE		
Investments in Associated Organizations	\$ 11,741,174	\$ 11,434,891
Other Investments		14,000,000
	<u>\$ 11,741,174</u>	<u>\$ 25,434,891</u>
CURRENT ASSETS		
Cash and Cash Equivalents	\$ 74,756	\$ 36,792,681
Accounts Receivable - Energy (Less allowance for uncollectibles of \$1,365,829 in 2015 and \$54,424 in 2014)	20,893,343	18,982,394
Accounts Receivable - Other (Less allowance for uncollectibles of \$232,899 in 2015 and \$202,509 in 2014)	6,790,514	6,188,313
Unbilled Revenue	23,069,694	25,475,400
Materials and Supplies Inventory	27,576,113	27,433,715
Power Cost Adjustments - Under-Recovered		6,321,464
Other Current and Accrued Assets	1,681,908	2,338,360
Total Current Assets	<u>\$ 80,086,328</u>	<u>\$ 123,532,327</u>
DEFERRED CHARGES AND OTHER ASSETS	\$ 81,831,544	\$ 67,674,449
TOTAL ASSETS	<u>\$ 1,429,554,177</u>	<u>\$ 1,414,715,776</u>

EQUITIES AND LIABILITIES

EQUITIES		
Memberships	\$ 11,127,363	\$ 10,734,531
Patronage Capital	373,806,190	366,671,229
Other Equities	152,018,032	131,462,672
Total Equities	<u>\$ 536,951,585</u>	<u>\$ 508,868,432</u>
LONG-TERM DEBT		
Mortgage Bonds Less Current Maturities	\$ 325,480,000	\$ 415,355,000
CFC Mortgage Notes Less Current Maturities	303,139,848	216,645,843
Total Long-Term Debt	<u>\$ 628,619,848</u>	<u>\$ 632,000,843</u>
ACCUMULATED PROVISION FOR PENSIONS AND BENEFITS	\$ 107,885,842	\$ 126,472,652
CURRENT LIABILITIES		
Current Maturities of Long-Term Debt	\$ 28,380,995	\$ 28,194,069
Purchased Power - Payable and Accrued	27,037,435	53,826,069
Accounts Payable - Other	26,845,131	26,010,886
Power Cost Adjustments - Over-Recovered	3,472,762	-
Tax Payable	7,631,053	8,278,302
Interest Payable	3,336,077	4,337,949
Member Deposits	5,715,712	5,563,618
Other Current and Accrued Liabilities	7,361,180	4,288,229
Total Current Liabilities	<u>\$ 109,780,345</u>	<u>\$ 130,499,122</u>
DEFERRED CREDITS	\$ 46,316,557	\$ 16,874,727
TOTAL EQUITIES AND LIABILITIES	<u>\$ 1,429,554,177</u>	<u>\$ 1,414,715,776</u>

See accompanying notes to financial statements.

PEDERNALES ELECTRIC COOPERATIVE, INC.

**STATEMENTS OF INCOME AND PATRONAGE CAPITAL
FOR THE YEARS ENDED DECEMBER 31, 2015 AND 2014**

	December 31,	
	<u>2015</u>	<u>2014</u>
OPERATING REVENUES		
Residential	\$ 432,113,791	\$ 447,503,383
Small Power	65,786,190	67,221,343
Industrial	9,156,794	9,721,872
Large Power	79,738,646	83,117,374
Public Authorities	721,625	763,197
Other Operating Revenues	26,147,996	29,161,259
Unbilled Revenue	(2,405,706)	(928,800)
Power Cost Adjustment	(21,651,734)	(14,070,174)
Total Operating Revenues	<u>\$ 589,607,602</u>	<u>\$ 622,489,454</u>
OPERATING EXPENSES		
Purchased Power	\$ 350,009,858	\$ 385,003,269
Transmission - Operation	891,427	1,044,586
Transmission - Maintenance	2,986,799	1,987,323
Distribution - Operation	27,936,940	32,544,525
Distribution - Maintenance	13,677,205	16,479,517
Consumer Accounts	29,375,435	24,938,133
Customer Service and Information	2,228,115	3,401,558
Sales	775,304	900,259
Administrative and General	29,336,463	27,254,620
Depreciation	54,533,299	51,905,921
Taxes	6,552,072	5,666,605
Other Deductions	491,978	422,861
Total Operating Expenses	<u>\$ 518,794,895</u>	<u>\$ 551,549,177</u>
OPERATING MARGINS - Before Fixed Charges	<u>\$ 70,812,707</u>	<u>\$ 70,940,277</u>
FIXED CHARGES		
Interest and Amortization on Long-Term Debt	\$ 37,999,680	\$ 39,346,673
Interest Charged to Construction	(1,373,756)	(591,048)
	<u>\$ 36,625,924</u>	<u>\$ 38,755,625</u>
OPERATING MARGINS - After Fixed Charges	<u>\$ 34,186,783</u>	<u>\$ 32,184,652</u>
Capital Credits	<u>1,016,171</u>	<u>985,866</u>
NET OPERATING MARGINS	<u>\$ 35,202,954</u>	<u>\$ 33,170,518</u>
NON-OPERATING MARGINS		
Interest and Dividend Income	\$ 184,073	\$ 306,046
Misc. Non-Operating Income	176,933	149,504
Gain/(Loss) on Disposal of Assets	44,959	(485,341)
	<u>\$ 405,965</u>	<u>\$ (29,791)</u>
NET MARGINS	<u>\$ 35,608,919</u>	<u>\$ 33,140,727</u>
COMPREHENSIVE INCOME	<u>\$ 35,608,919</u>	<u>\$ 33,140,727</u>
PATRONAGE CAPITAL - BEGINNING OF YEAR	366,671,229	378,650,152
Patronage Capital Retired	(8,097,695)	(12,857,119)
Transfers to Other Equities	<u>(20,376,263)</u>	<u>(32,262,531)</u>
PATRONAGE CAPITAL - END OF YEAR	<u>\$ 373,806,190</u>	<u>\$ 366,671,229</u>

See accompanying notes to financial statements.

PEDERNALES ELECTRIC COOPERATIVE, INC.

STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2015 AND 2014

	December 31,	
	2015	2014
CASH FLOWS FROM OPERATING ACTIVITIES		
Net Margins	\$ 35,608,919	\$ 33,140,727
Adjustments to Reconcile Net Margins to Net Cash Provided by Operating Activities		
Depreciation and Amortization Charged to Expense	55,219,518	52,292,020
Provision for Uncollectible Accounts	1,770,351	615,210
Capital Credits	(1,016,171)	(985,866)
Deferral/Accrual/Asset Activity for Pension/Post-retirement Plans	12,641,894	11,978,274
Payments on Post-Retirement Benefits	(1,819,628)	(1,864,800)
Payments to Defined Benefit Plan	(10,200,000)	(14,390,000)
Changes in Assets and Liabilities:		
Accounts Receivable - Net	(4,283,501)	1,728,273
Accrued Unbilled Revenue	2,405,706	928,800
Power Cost Adjustments	9,794,226	(7,489,878)
Materials & Supplies	(142,398)	(4,880,771)
Prepayments & Other Current Assets	656,452	(755,275)
Deferred Charges & Other Assets	(12,315,950)	18,085,016
Accrued & Accounts Payable	(25,954,479)	7,884,623
Member Deposits	152,094	747,546
Accrued Taxes	(647,249)	(267,805)
Accrued Interest	(1,001,872)	(202,463)
Other Current Liabilities	3,113,041	366,134
Other Deferred Credits & Liabilities	7,665,390	6,169,682
Net Cash Provided by Operating Activities	<u>\$ 71,646,343</u>	<u>\$ 103,099,447</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Net Additions to Property, Plant & Equipment	\$ (112,354,321)	\$ (90,805,965)
Redemption of Other Investments	14,000,000	-
Capital Credit Retirements from Associated Organizations	709,888	861,689
Net Cash Used in Investing Activities	<u>\$ (97,644,433)</u>	<u>\$ (89,944,276)</u>
CASH FLOWS FROM FINANCING ACTIVITIES		
Payments on Long-Term Debt	\$ (28,194,069)	\$ (26,520,455)
Advances on Long-Term Debt	25,000,000	-
Retirement of Patronage Capital	(8,097,695)	(12,857,119)
Transfers of Other Equities	179,097	(94,852)
Increase in Memberships - Net	392,832	406,009
Net Cash Used in Financing Activities	<u>\$ (10,719,835)</u>	<u>\$ (39,066,417)</u>
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	\$ (36,717,925)	\$ (25,911,246)
CASH AND CASH EQUIVALENTS - BEGINNING OF YEAR	<u>36,792,681</u>	<u>62,703,927</u>
CASH AND CASH EQUIVALENTS - END OF YEAR	<u>\$ 74,756</u>	<u>\$ 36,792,681</u>
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION		
Cash Paid During the Year for:		
Interest on Long-Term Debt	\$ 38,402,398	\$ 39,155,024
Patronage Capital Retired by Noncash Discounting	\$ 20,376,263	\$ 32,262,531
Debt Refinanced in a Noncash Transaction	\$ 78,200,000	\$ -

See accompanying notes to financial statements.

PEDERNALES ELECTRIC COOPERATIVE, INC.

NOTES TO FINANCIAL STATEMENTS

1. Nature of Operations and Summary of Significant Accounting Policies

Nature of Operations

Pedernales Electric Cooperative, Inc. (the Cooperative) is a non-profit corporation organized to provide electric service at the retail level to primarily residential and commercial accounts in a designated service area. As of December 31, 2015, the Cooperative served approximately 275,280 meters.

Power delivered at retail is purchased wholesale from the Lower Colorado River Authority (LCRA) and other third-party wholesale power suppliers. Any revenues earned in excess of costs incurred are allocated to members of the Cooperative and are reflected as patronage capital on the balance sheet.

Regulatory Accounting

The Cooperative utilizes the Uniform System of Accounts established by the Rural Utilities Service (RUS). In accordance with Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 980, Regulated Operations, the Cooperative records certain assets and liabilities in accordance with the economic effects of the rate making process.

Utility Plant

Plant is stated at the original cost of construction which includes the cost of contracted services, direct labor, materials, and overhead items. Contributions from others toward the construction of electric plant are credited to the applicable plant accounts.

When property, which represents a retirement unit, is replaced or removed, the average cost of such property as determined from the continuing property records is credited to electric plant and such cost, together with cost of removal less salvage, is charged to the accumulated provision for depreciation.

Maintenance and repairs, including the renewal of minor items of plant not comprising a retirement unit, are charged to the appropriate maintenance accounts, except that repairs of transportation and service equipment are charged to clearing accounts and redistributed to operating expense and other accounts.

Cash and Cash Equivalents

For purposes of the statements of cash flows, cash and short-term investments are considered cash and cash equivalents.

Accounts Receivable

In the normal course of business the Cooperative recognizes accounts receivable for energy delivered and billed. The Cooperative provides a statement with a due date that will not be less than 16 days after the statement date. Payments not received by the due date are considered delinquent.

The Cooperative provides an allowance for uncollectible accounts to recognize the portion of receivables considered uncollectible. The allowance is estimated based on historical trends, aging of receivables, and review of potential bad debts. Accounts remaining unpaid 120 days after the due date of the final bill are written off.

PEDERNALES ELECTRIC COOPERATIVE, INC.

NOTES TO FINANCIAL STATEMENTS

Unbilled Revenue

At December 31, 2015 and 2014 the Cooperative had \$23,069,694 and \$25,475,400 of unbilled revenue consisting of its revenue accrued for power delivered but not billed and its revenue accrued attributable to purchased power.

Materials and Supplies Inventory

Materials and supplies inventories are valued at average unit cost.

Electric Revenues

The Cooperative records electric revenues as billed to customers on a monthly basis. Revenue is accrued for power delivered but not billed at the end of each month.

The Cooperative's tariffs for electric service include adjustment clauses under which billings to customers are adjusted to reflect changes in the cost of purchased power. In order to match power cost and related revenues these amounts to be billed to consumers in subsequent periods are included with the revenue accrual described above.

In December 2015, the Cooperative rebated 2015 revenue by applying a \$.00560 credit to consumer bills. This resulted in a revenue rebate of approximately \$2.2 million.

The Cooperative reduced the delivery charge component of the tariffs for electric service in December 2014. The reduction resulted in a 5 mil (\$.005) decrease in the delivery charge.

Federal Income Taxes

The Cooperative is exempt from federal income taxes under Section 501(c)(12) of the Internal Revenue Code. More than 85% of the gross income is collected from members.

The Cooperative follows the "uncertain tax positions" provisions of accounting principles generally accepted in the United States of America. The primary tax position of the Cooperative is its filing status as a tax exempt entity. The Cooperative determined that it is more likely than not that its tax positions will be sustained upon examination by the Internal Revenue Service (IRS) and that all tax benefits are likely to be realized upon settlement with taxing authorities.

The Cooperative files income tax returns in the U.S. federal jurisdiction. The Cooperative is no longer subject to examinations by federal taxing authorities for years before 2012. In 2015 and 2014, the Cooperative did not incur tax related interest or penalties.

Group Concentration of Credit Risk

The Cooperative's headquarters facility is located in Johnson City, Texas. The service area extends into 24 counties in the Central Texas region. The Cooperative records a receivable for electric revenues as billed on a monthly basis. The Cooperative may require a deposit from new members upon connection which is applied to unpaid bills and fees in the event of default. The deposit accrues interest annually and is returned to residential accounts along with accrued interest after one year of prompt payments. As of December 31, 2015 and 2014, deposits on hand totaled \$5,715,712 and \$5,563,618, respectively.

PEDERNALES ELECTRIC COOPERATIVE, INC.

NOTES TO FINANCIAL STATEMENTS

The Cooperative maintains its cash balances in institutions insured by the Federal Deposit Insurance Corporation (FDIC). The cash balances exceeded applicable insurance coverage at times during 2015 and 2014.

Patronage Capital Certificates

Patronage capital from associated organizations is recorded at the stated amount of the certificate.

Defined Benefit Plan and Other Post-Retirement Benefits

The Cooperative has a defined benefit pension plan (Plan) for employees meeting eligibility requirements. In 2005, the Plan was amended to close entry to new participants after January 1, 2006. The benefit is based on years of service and the average of the employee's highest 36 months of compensation.

The Cooperative also sponsors a health care plan for retirees who satisfy eligibility requirements. The cost of the Cooperative's obligation is actuarially determined based on certain weighted-average assumptions.

Use of Estimates in the Preparation of Financial Statements

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

Reclassification and Comparative Information

Some 2014 amounts have been reclassified to be consistent with 2015 amounts.

2. Assets Pledged

Substantially all assets are pledged as security for the long-term debt due to Bank of New York (BONY) and National Rural Utilities Cooperative Finance Corporation (CFC).

3. Utility Plant

The major classes of utility plant are as follows:

	December 31,	
	2015	2014
Transmission Plant	\$ 102,537,684	\$ 98,720,311
Distribution Plant	1,258,670,132	1,204,977,381
General Plant	126,600,078	139,855,112
Total Utility Plant in Service	\$ 1,487,807,894	\$ 1,443,552,804
Construction Work in Progress	61,833,058	53,561,428
Total Utility Plant	\$ 1,549,640,952	\$ 1,497,114,232

PEDERNALES ELECTRIC COOPERATIVE, INC.

NOTES TO FINANCIAL STATEMENTS

Provision for depreciation of utility plant is computed using straight-line rates as follows:

Transmission Plant	2.75%
Distribution Plant	2.05% - 20.00%
General Plant	2.50% - 20.00%

Depreciation for the years ended December 31, 2015 and 2014, was \$57,436,883 and \$54,935,826, respectively, of which \$54,533,299 and \$51,905,921 was charged to depreciation expense and \$2,903,584 and \$3,029,905 was allocated to other accounts.

4. Investments in Associated Organizations

Investments in associated organizations consisted of:

	December 31,	
	2015	2014
CFC		
Capital Term Certificates	\$ 4,887,296	\$ 4,887,296
Patronage Capital	3,614,457	3,237,783
Texas Electric Cooperative		
Patronage Capital	2,992,557	3,132,282
Other	246,864	177,530
	<u>\$ 11,741,174</u>	<u>\$ 11,434,891</u>

5. Materials and Supplies Inventory

Materials and supplies inventories consist of construction materials and supplies. The ending balances for materials and supplies at December 31, 2015 and 2014 were \$27,576,113 and \$27,433,715, respectively.

6. Deferred Charges and Other Assets

Deferred charges and other assets included the following:

	December 31,	
	2015	2014
Regulatory Asset - Defined Benefit Plan	\$ 58,626,574	\$ 56,059,210
Unamortized Debt Issuance Costs	3,279,252	3,935,471
Regulatory Asset - LCRA FPCRF	6,975,344	273,863
Regulatory Asset - GIS Inventory	9,294,924	3,756,444
Regulatory Asset - Facility Costs	2,628,633	2,008,646
Regulatory Asset - Software Implementation	-	397,826
LCRA Radio Services	1,026,817	1,242,989
	<u>\$ 81,831,544</u>	<u>\$ 67,674,449</u>

PEDERNALES ELECTRIC COOPERATIVE, INC.

NOTES TO FINANCIAL STATEMENTS

The Cooperative recognizes a regulatory asset for the portion of its pension and other post-retirement benefit plans that has not been recognized as a component of net periodic pension and other post-retirement benefit costs. Accordingly, no amounts have been recorded in other comprehensive income. The unrecognized portion is being amortized into pension and other post-retirement benefit costs over the average future service of current active plan participants expected to receive benefits.

Costs incurred with respect to the issuance of bonds have been capitalized and are being amortized over the terms of the bonds.

The LCRA fuel & power cost recovery factor (FPCRf) represents the amount that the Cooperative will be billed by LCRA in future periods for electricity previously purchased. Since this amount will be collected from members in the future through the power cost adjustment (PCA), it is classified as a regulatory asset. A corresponding liability is also recorded for the same amount.

The GIS Inventory regulatory asset represents the deferral of costs incurred by the Cooperative in performing a GPS survey and field inventory of the transmission and distribution system. The deferral of the cost through the ratemaking process was approved by the Cooperative's Board of Directors and will be recovered over a period of 15 years. Amortization began in 2015 and \$418,306 was charged to expense in 2015.

The Facility Costs regulatory asset represents the deferral of the facility repair expenses that were incurred as a result of the Facility Assessment Study. The Study recommended significant and costly repairs and renovations to the Cooperative's facilities. The deferral of the cost through the ratemaking process was approved by the Cooperative's Board of Directors and will be recovered over a period of up to 10 years. Amortization began in 2015 and \$995,351 was charged to expense in 2015.

The Software Implementation regulatory asset at December 31, 2014 represented the deferral of costs associated with implementing software. The deferral of the cost through the ratemaking process was approved by the Cooperative's Board of Directors and to be recovered over a period of up to 5 years. This item was fully amortized in 2015 with \$700,000 charged to expense.

The Cooperative has an agreement in place to utilize LCRA's trunked radio system in the Junction district. The associated costs were paid upon initiation of the agreement. The costs have been capitalized and are being amortized over the contract term, which ends in August 2020.

7. Patronage Capital and Other Equities

Patronage capital represents the Cooperative's accumulated retained net margins that have been allocated annually to its members. Distributions to members are made at the discretion of the Board of Directors in accordance with the bylaws, subject to the covenants contained in the long-term debt agreements.

The loan agreements contain provisions that must be met for the Cooperative to make patronage capital retirements. These provisions include maintaining debt service coverage ratios of 1.15 for the BONY bonds and 1.35 for CFC debt. The Cooperative is in compliance with these provisions at December 31, 2015 and 2014.

PEDERNALES ELECTRIC COOPERATIVE, INC.

NOTES TO FINANCIAL STATEMENTS

Under certain circumstances, the Board of Directors may choose to retire patronage capital earlier than the Cooperative's current approximate 30 year retirement schedule. In these instances, the Cooperative retires and pays the net present value of patronage capital to a member or former member before the time the Cooperative anticipates normally retiring and paying patronage capital.

Patronage capital totaling \$8,097,695 and \$12,857,119 was distributed to members during 2015 and 2014, respectively.

Patronage capital assigned and assignable at December 31, 2015 and 2014, is as follows:

	December 31,	
	2015	2014
Assigned to Date	\$ 553,588,934	\$ 519,340,309
Assignable	<u>61,084,319</u>	<u>59,544,928</u>
	\$ 614,673,253	\$ 578,885,237
Less: Retirements to Date	88,849,031	80,751,336
Less: Discounted Patronage Capital to Permanent Equity	<u>152,018,032</u>	<u>131,462,672</u>
	<u>\$ 373,806,190</u>	<u>\$ 366,671,229</u>

The Cooperative's bylaws provide that amounts received by the Cooperative in excess of costs and expenses shall, insofar as permitted by law, (a) be used to offset any losses incurred during the current or any prior fiscal year and, (b) to the extent not needed for that purpose, be allocated to its members on a patronage basis.

Other equities at December 31, 2015 and 2014, are as follows:

	December 31,	
	2015	2014
Discounted Capital Credits	<u>\$ 152,018,032</u>	<u>\$ 131,462,672</u>

PEDERNALES ELECTRIC COOPERATIVE, INC.

NOTES TO FINANCIAL STATEMENTS

8. Long-Term Debt

At December 31, 2015 and 2014, long-term debt consisted of the following:

	December 31,	
	2015	2014
Senior Mortgage Bonds, Series 1993; 8.55%; was due 2020 Interest Payable Semi-annually on May 15 and November 15; Paid in Full 2015	\$ -	\$ 65,000,000
Senior Mortgage Bonds, Series 1993; 8.85%; was due 2016 Interest Payable Semi-annually on May 15 and November 15; Paid in Full 2015	-	15,000,000
First Mortgage Bonds, 1995 Series A; 7.55%; due and paid 2015 Interest Payable Semi-annually on May 15 and November 15; Principal Payments began 1996	-	10,862,000
First Mortgage Bonds, 2002 Series A; 5.952%; due 2022 Interest Payable Semi-annually on May 15 and November 15;	97,655,000	108,675,000
First Mortgage Bonds, 2002 Series A; 6.202%; due 2032 Interest Payable Semi-annually on May 15 and November 15; Principal Payments begin 2023	239,500,000	239,500,000
CFC Loan; 3.85%; due 2043 Interest and Principal Payable Quarterly Principal Payments began 2012	216,645,843	221,157,912
CFC Loan; 3.95%; due 2045 Interest and Principal Payable Quarterly Principal Payments begin 2016	25,000,000	-
CFC Loan; 2.75%; due 2020 Interest and Principal Payable Quarterly Principal Payments begin 2016	78,200,000	-
	\$ 657,000,843	\$ 660,194,912
Less: Current Maturities	28,380,995	28,194,069
Total Long-Term Debt	\$ 628,619,848	\$ 632,000,843

The Cooperative has \$166,800,000 available on long-term loan commitments from CFC. These loans are available for drawdown through 2019.

Annual maturities of long-term debt for the next five years and thereafter are as follows:

2016	\$ 28,380,995
2017	33,643,953
2018	35,031,109
2019	36,468,758
2020	37,987,566
Thereafter	485,488,462

PEDERNALES ELECTRIC COOPERATIVE, INC.

NOTES TO FINANCIAL STATEMENTS

9. Short-Term Borrowing

The Cooperative has a line of credit at a variable interest rate with CFC not to exceed \$100,000,000. There was no balance outstanding at December 31, 2015 and 2014. The line of credit agreement requires the Cooperative to pay down the balance to zero annually and automatically renews unless either party gives a 90 day notice.

10. Deferred Credits

Deferred credits include the following:

	December 31,	
	2015	2014
Patronage Capital - Pre-Escheat	\$ 8,250,767	\$ 7,745,775
Contributions in Aid of Construction	-	4,414,309
Regulatory Liability - LCRA FPCRF	15,237,048	3,653,403
Post-Retirement Medical Benefits Regulatory Liability	22,813,682	1,037,242
Unclaimed Property Payable	15,060	23,998
	<u>\$ 46,316,557</u>	<u>\$ 16,874,727</u>

The patronage capital pre-escheat component represents unclaimed patronage capital checks that do not meet escheat criterion. The liability is recorded as unclaimed patronage capital as the checks are voided. As the funds are claimed or reach escheat status, the liability is reduced.

The contributions in aid of construction component represent funds received for construction projects. Beginning in 2015, this amount will be reflected in Construction Work in Progress (CWIP) and not recorded to CIAC Deferred Credits as reported in previous years.

During 2015 and 2014, the Cooperative realized a gain for post-retirement medical benefits. The Cooperative recognized a regulatory liability for the net amount of the unrecognized gain.

11. LCRA Fuel & Power Cost Recovery Factor (FPCRF)

The Fuel and Power Cost Recovery Factor represents over or under-recovered cost adjustments for electricity purchased from LCRA. During 2015, there were two components of the FPCRF that were recorded. The amount under-recovered by LCRA as of June 30, 2015 was recorded separately from the adjustments that occurred from July 1, 2015 – December 31, 2015.

The FPCRF activity that occurred from July 1, 2015 – December 31, 2015 represents an over-recovery by LCRA of \$6,975,344, which is classified as a receivable on the balance sheet.

PEDERNALES ELECTRIC COOPERATIVE, INC.

NOTES TO FINANCIAL STATEMENTS

12. Commitments and Contingencies

Power Supply Contracts

The Cooperative entered into contracts for the purchase and delivery of electric energy to satisfy its electric energy requirements. In 2015 and 2014, the Cooperative purchased energy from the Lower Colorado River Authority (LCRA) and other third party wholesale power suppliers. LCRA was the primary wholesale electric energy supplier, while the other suppliers supplied electric energy to serve a portion of the electric energy requirements for the Cooperative's delivery points within LCRA's service territory and the full electric energy requirements for delivery points outside of LCRA's service territory. All of the electric energy purchased by the Cooperative is procured through term contracts of varying durations. As these terms expire, they may or may not be replaced with new agreements.

Transmission Lease Contracts

LCRA leases and operates certain transmission facilities and equipment owned by the Cooperative. Payments for the leased facilities vary from year to year and are based on the original cost of the facilities, adjusted for depreciation, and are updated annually to reflect additions, retirements and depreciation. The terms of the lease are perpetual, but may be terminated by LCRA or the Cooperative upon five years written notice. The Cooperative's transmission lease revenues totaled \$5,138,308 and \$5,168,573 in 2015 and 2014, respectively.

Litigation

The Cooperative may be involved in various claims and litigation arising in the normal course of business. Although management is unable to predict the outcome of such proceedings, management and the Cooperative's legal counsel do not believe that the resolution of any claims or litigation involving the Cooperative will have a material adverse effect on the Cooperative's results of operations and financial condition.

13. Pension Benefits

The Cooperative has a defined benefit plan covering eligible employees. The cost of the plan is determined by an independent actuary and is funded in amounts sufficient to meet the minimum funding requirements under applicable regulations.

Contributions paid to the defined benefit plan for the years ended December 31, 2015 and 2014, were \$10,200,000 and \$14,390,000, respectively.

The measurement date used for the current valuation is December 31, 2015.

The following weighted-average assumptions were used to develop the accumulated post-retirement benefit obligation for 2015 and 2014:

	<u>2015</u>	<u>2014</u>
Discount Rate	4.40%	4.10%
Rate of Compensation Increase	4.00%	4.16%

PEDERNALES ELECTRIC COOPERATIVE, INC.

NOTES TO FINANCIAL STATEMENTS

The following weighted-average assumptions were used to determine the net benefit cost for 2015 and 2014:

	<u>2015</u>	<u>2014</u>
Discount Rate	4.10%	4.85%
Rate of Compensation Increase	4.16%	3.79%
Expected Long-Term Return on Plan Assets	6.50%	6.50%

Amounts recognized in the Cooperative's financial statements and funded status of the plan are as follows:

	<u>December 31,</u>	
	<u>2015</u>	<u>2014</u>
I) Net Periodic Benefit Cost		
Service Cost	\$ 5,312,209	\$ 4,424,504
Interest Cost	8,280,035	8,525,762
Amortization	4,462,282	2,207,332
Return on Assets	<u>(10,241,908)</u>	<u>(9,154,893)</u>
	<u>\$ 7,812,618</u>	<u>\$ 6,002,705</u>
II) Projected Benefit Obligation		
(PBO) Reconciliation:		
PBO Balance at Beginning of Year	\$ 205,584,993	\$ 168,900,397
Actuarial (Gain)/Loss	(4,189,883)	30,760,007
Interest Cost/Service Cost	13,592,244	12,950,266
Benefits Paid	<u>(7,151,489)</u>	<u>(7,025,677)</u>
Projected Benefit Obligation at Year End	<u>\$ 207,835,865</u>	<u>\$ 205,584,993</u>
III) Reconciliation of Funded Status		
Projected Benefit Obligation	\$ 207,835,865	\$ 205,584,993
Fair Value of Assets	<u>155,938,693</u>	<u>153,867,803</u>
Funded Status at Year End	<u>\$ (51,897,172)</u>	<u>\$ (51,717,190)</u>
IV) Accumulated Other Comprehensive Loss		
Actuarial Loss - Beginning of Year	\$ 56,059,210	\$ 25,008,957
Amortization of Loss/Remeasurement	(4,462,282)	(2,207,332)
Actuarial (Gain)/Loss	<u>7,029,646</u>	<u>33,257,585</u>
Other Comprehensive Loss	<u>\$ 58,626,574</u>	<u>\$ 56,059,210</u>

The accumulated benefit obligation for the plan was \$186,242,484 and \$181,861,286 at December 31, 2015 and 2014, respectively.

Plan Asset Information

Information related to fair value hierarchy measurements are disclosed in Note 15. The defined benefit plan asset fair value measurements are substantially Level 1.

PEDERNALES ELECTRIC COOPERATIVE, INC.

NOTES TO FINANCIAL STATEMENTS

Fair value of plan assets at December 31, 2015 and 2014 and asset allocation follows:

	December 31,	
	2015	2014
Cash and Cash Equivalents	\$ 2,040,637	\$ 4,281,939
Government Agencies, Bonds and Notes	59,073,500	58,019,262
Mutual Funds	81,841,441	78,058,878
Other	12,983,115	13,507,724
Total	\$ 155,938,693	\$ 153,867,803

	December 31,	
	2015	2014
Mutual Funds and Equity Securities	52%	51%
Debt Securities	38%	38%
Other	10%	11%
Total	100%	100%

Benefit payments for the next ten years are estimated as follows:

2016	\$ 7,900,153
2017	8,280,021
2018	8,650,238
2019	9,024,640
2020	9,602,283
2021-2025	57,982,399

The estimated 2016 plan year minimum required contribution is \$9,600,000.

The Cooperative has a defined contribution plan (401(k) plan) for employees that are eligible to participate. For employees that are also eligible to participate in the defined benefit plan, the maximum contribution is six percent of the employee's base annual salary. For employees not eligible for the defined benefit plan, the 401(k) plan contribution cost is a maximum of ten percent of the employee's base annual salary. These costs are funded each pay period as accrued. The Cooperative's contributions to the 401(k) plan (net of forfeitures) were \$3,543,298 and \$3,270,717 in 2015 and 2014, respectively.

14. Post-Retirement Benefits Other than Pensions

The Cooperative provides post-retirement medical benefits for eligible employees through a plan with a third-party insurance provider. For purposes of this statement, the written plan in effect is the substantive plan and is considered a defined benefit plan. The Cooperative contributes varying amounts dependent on retirement date, age, and years of service.

PEDERNALES ELECTRIC COOPERATIVE, INC.

NOTES TO FINANCIAL STATEMENTS

Benefits are paid on behalf of retirees and are a function of medical insurance costs and number of retirees. Benefits paid for the years ended December 31, 2015 and 2014, were \$2,067,512 and \$2,117,405, respectively.

The Cooperative's policy for contributions is to contribute the amount of the current benefits in that year.

The measurement date used for the current valuation is December 31, 2015.

The weighted-average discount rate used to develop the accumulated post-retirement benefit obligation for the years ended December 31, 2015 and 2014, were 4.40% and 4.12%, respectively. The assumed health care cost trend rate is 8.50% percent for 2015, declining to an ultimate level of 5.00% over seven years.

Amounts recognized in the Cooperative's financial statements and funded status of the plan are as follows:

	December 31,	
	2015	2014
I) Net Post-retirement Benefit Cost		
Service Cost	\$ 1,246,396	\$ 1,323,302
Interest Cost	2,972,836	3,282,722
Amortization	610,494	1,369,545
	\$ 4,829,726	\$ 5,975,569
II) Accumulated Post-retirement Benefit Obligation		
(APBO) Reconciliation:		
APBO Balance at Beginning of Year	\$ 74,755,462	\$ 70,098,804
Actuarial (Gain)/Loss	(21,165,946)	1,915,434
Interest Cost / Service Cost	4,218,782	4,606,024
Employer Contributions Net of Participant Amounts	(1,819,628)	(1,864,800)
Net Post-retirement Benefit Liability at Year End	\$ 55,988,670	\$ 74,755,462
III) Reconciliation of Funded Status		
APBO	\$ 55,988,670	\$ 74,755,462
Accrued Post-retirement Benefit Cost	\$ 55,988,670	\$ 74,755,462
IV) Accumulated Other Comprehensive Items		
Actuarial Loss (Gain) - Beginning of Year	\$ (1,037,242)	\$ (1,583,131)
Amortization	(610,494)	(1,369,545)
Current Year Net (Gain)/Loss	(21,165,946)	1,915,434
Other Comprehensive (Gain) Loss	\$ (22,813,682)	\$ (1,037,242)

The estimated actuarial loss for the post-retirement medical benefit plan that will be amortized from accumulated other comprehensive income into net post-retirement benefit cost over the next fiscal year is expected to be a gain of \$2,424,622.

PEDERNALES ELECTRIC COOPERATIVE, INC.

NOTES TO FINANCIAL STATEMENTS

The Cooperative has not funded any plan assets as of December 31, 2015 or 2014.

Estimated future benefit payments for the next ten years are as follows:

2016	\$	2,132,271
2017		2,253,250
2018		2,407,405
2019		2,598,694
2020		2,752,907
2021-2025		15,761,086

15. Disclosures About Fair Value of Financial Instruments

Many of the Cooperative's financial instruments lack an available market with similar terms, conditions, and maturities as those reflected in the carrying amount recorded. Accordingly, significant assumptions, estimations, and present value calculations were used for purposes of this disclosure.

Estimated Fair Value has been determined by calculating the present value of financial instruments using the best data available.

Fair Value for some amounts carried on the financial statements has not been calculated for the following reasons:

Patronage Capital from Associated Organizations – The right to receive cash is an inherent component of a financial instrument. The Cooperative holds no right to receive cash since any payments are at the discretion of the governing body for the associated organizations. As such, Patronage Capital from Associated Organizations is not considered financial instruments.

CFC Capital Term Certificates and Member Capital Securities – It is not practicable to estimate fair value for these financial instruments given the lack of a market and their long holding period. Relevant information with respect to these is as follows:

	AMOUNT	INTEREST RATE	MATURITY
\$	960,968	3.00%	2020-2030
	1,715,690	0.00%	2043
	2,210,638	5.00%	2070-2080

Cash and Short-Term Investments - The recorded book value approximates fair value given the short period to maturity.

Long-Term Debt - Estimated by computing the present value by individual note to maturity, using currently quoted or offered rates for similar issues of debt. The year-end CFC fixed interest rate for long-term debt was used in the calculation for all fixed rate long-term debt. These are the only financial instruments of the Cooperative that have a difference in Fair Value and Carrying Value.

PEDERNALES ELECTRIC COOPERATIVE, INC.

NOTES TO FINANCIAL STATEMENTS

The carrying values of the Cooperative's financial instruments and debt and the estimated fair values are as follows:

	December 31, 2015		December 31, 2014	
	CARRYING VALUE	FAIR VALUE	CARRYING VALUE	FAIR VALUE
Assets:				
Cash and Cash Equivalents	\$ 74,756	\$ 74,756	\$ 36,792,681	\$ 36,792,681
Short-Term Investments	-	-	14,000,000	14,000,000
Long-Term Investments	-	-	-	-
Patronage Capital and Capital Term Certificates	11,741,174	11,741,174	11,434,891	11,434,891
Liabilities:				
Long-Term Debt	657,000,843	619,291,348	660,194,912	635,917,084

Fair Value Hierarchy

The Fair Value Measurements Topic of the FASB Accounting Standards Codification establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to measurements involving significant unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy are as follows:

Level 1 - inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the Cooperative has the ability to access at the measurement date.

Level 2 - inputs are inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly.

Level 3 - inputs are unobservable inputs for the asset or liability.

Long-Term Debt valuations are considered Level 2.

16. Subsequent Events

The Cooperative has evaluated subsequent events through April 7, 2016, the date which the financial statements were available to be issued.

Subsequent to year end, the Cooperative reached an agreement with CoBank for an unsecured line-of-credit in the amount of \$200,000,000.

BOLINGER, SEGARS, GILBERT & MOSS, L.L.P.

CERTIFIED PUBLIC ACCOUNTANTS

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**LETTER TO BOARD OF DIRECTORS REGARDING POLICIES CONCERNING
AUDITS OF CFC BORROWERS**

Board of Directors
Pedernales Electric Cooperative, Inc.
Johnson City, Texas

We have audited, in accordance with auditing standards generally accepted in the United States of America, the balance sheets of Pedernales Electric Cooperative, Inc. (the Cooperative) as of December 31, 2015 and 2014, and the related statements of income and patronage capital and cash flows for the years ended, and have issued our report thereon dated April 7, 2016.

In connection with our audit, nothing came to our attention that caused us to believe that the Cooperative failed to comply with the terms of Article V of the National Rural Utilities Cooperative Finance Corporation Loan Agreement insofar as they relate to accounting matters. However, our audits were not directed primarily toward obtaining knowledge of such incompliance.

This report is intended solely for the information and use of the Boards of Directors and management of Pedernales Electric Cooperative, Inc. and the National Rural Utilities Cooperative Finance Corporation and is not intended to be and should not be used by anyone other than these specified parties.

Bolinger, Segars, Gilbert & Moss LLP

Certified Public Accountants

Lubbock, Texas

April 7, 2016