

Northland Power Income Fund

1997 ANNUAL REPORT



delivering performance



**NORTHLAND POWER
INCOME FUND**

NORTHLAND POWER INCOME FUND



The Northland Power Income Fund (the "Fund") is a trust that was established in 1997 to acquire a 110 megawatt cogeneration power plant located in Iroquois Falls, Ontario (the "Facility").

Through its wholly-owned subsidiary, Iroquois Falls Power Corp. ("IFPC"), the Fund owns and operates the Facility which supplies electricity to Ontario Hydro and steam to the neighbouring Abitibi-Consolidated Inc. pulp and paper mill. The electricity and steam are sold and natural gas is purchased under long-term contracts, providing the Fund with considerable protection from price and volume fluctuations.

The Fund is administered and the Facility is managed by Iroquois Falls Power Management Inc., a wholly-owned subsidiary of Northland Power Inc., which is a leading Canadian independent power company with extensive experience in developing, engineering, financing, operating and maintaining private power projects.

As at April 20, 1998, the Fund had 30,823,443 trust units outstanding which trade on The Toronto Stock Exchange under the symbol NPI.UN. The units are qualified investments under the Canadian Income Tax Act for RRSPs and DPSPs and are not considered foreign property for such plans.

Abbreviations used in this Report

GJ	Gigajoules
kWh	Kilowatt hours
M	Million
MW	Megawatts
MWh	Megawatt hours

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The Highlights



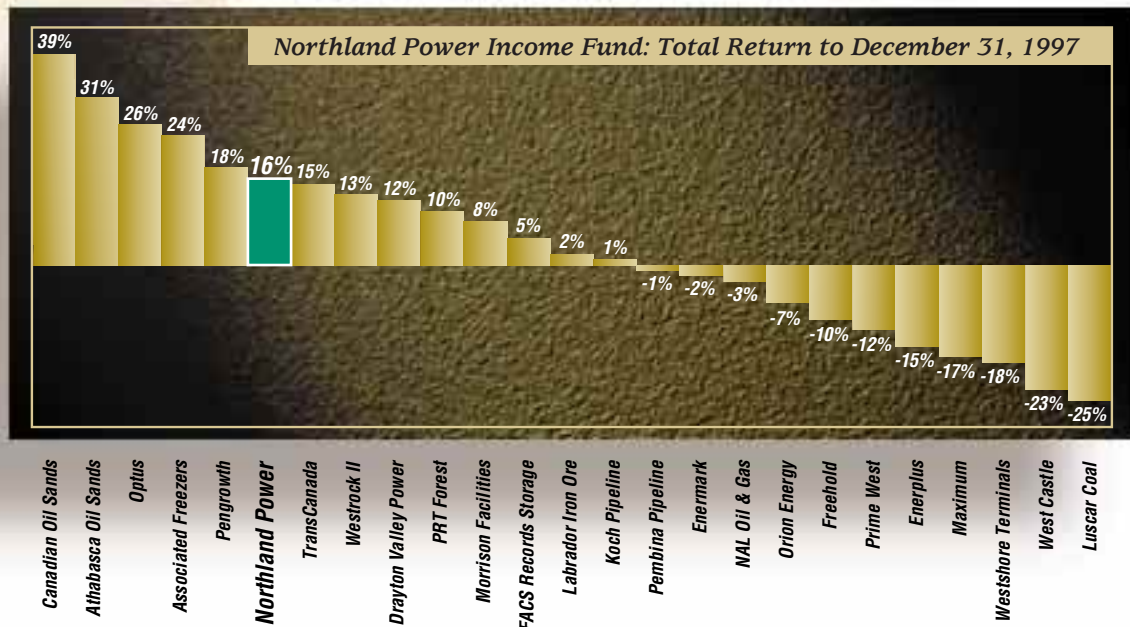
For the nine-month period ended December 31, 1997

Production	Actual	Prospectus
Electricity (MWh)	517,100	517,700
Steam (million lbs.)	770	715
Financial (\$'000s)		
Sales	\$38,691	\$37,019
Net Income	\$7,076	\$7,542
Funds from operations before working capital changes	\$19,531	\$19,054
Cash generated from operations	\$17,973	\$18,538
Distributions declared to unitholders (\$'000s)	\$18,494	\$18,538
Distributions per unit (\$)	\$0.60	\$0.60

- Acquired the Facility effective April 1, 1997
- Received listing on The Toronto Stock Exchange on April 15, 1997 (trust unit: NPI.UN)
- Electricity and steam production met forecast in prospectus
- Achieved enviable safety record of no lost hours
- Met all Ministry of Environment requirements
- Distributions to unitholders on target at \$0.60 for nine months to December 31, 1997
- Second instalment of \$4 per unit paid April 15, 1998; instalment receipt loan repaid

Northland Power Income Fund's total return (distributions plus unit price increase), on a fully-paid basis, compares favourably to other royalty trusts.

—Data courtesy of CIBC Wood Gundy



The Manager's Statement



The reliable performance of the Facility... resulted in the Northland Power Income Fund achieving all its major objectives.

– James C. Temerty, President

LETTER TO UNITHOLDERS

Our theme this year, “delivering performance”, reflects the reliable performance of the Iroquois Falls cogeneration facility and the predictability of the Fund’s financial results.

Northland Power Inc.’s strategy in developing the Iroquois Falls project had three major elements. The first element was to build a highly efficient, state-of-the-art facility, capable of delivering electricity and steam to its customers with best-of-industry reliability. The second was to ensure stable and predictable profitability by securing long-term revenue generating contracts matched to major operating costs. The third element was to build a highly competent management and operations team for the Facility.

The results for the Facility’s first fiscal year of operations show that this strategy is working. For the nine months from inception to December 31, 1997, electricity production was on target while steam production exceeded the forecast in the prospectus (the “Forecast”) by about 8 per cent. Gas costs, net of sales, were below the Forecast because cost savings and profit from the sales more than offset higher consumption. The total of plant operating costs, amortization, and management and administrative costs was consistent with the Forecast. Although interest on the instalment receipt loan exceeded the Forecast, distributions to unitholders were not affected because the purchase price of the Facility was reduced to compensate for the higher interest cost. Distributions to unitholders of \$0.60 per unit were on target for the nine-month period.

When both cash distributions and potential capital gains are taken into account, investors who purchased trust units when they were issued earned a return of approximately 16 per cent in 1997 based on the issue price of \$10 per unit. Based on the \$6 per unit paid for the first instalment, the return was approximately 27 per cent to December 31, 1997. These results compare favourably to other royalty trusts and the 13 per cent rise in the TSE 300 index in 1997.

In 1998, our attention will be firmly focused on the task of achieving our financial target of distributing 93.4¢ per unit to unitholders for the 12 months ending December 31, 1998. The Ontario Government’s announced restructuring of the electricity marketplace may create opportunities in the short and long-term. We will closely monitor the restructuring process in order to assess opportunities that may arise.

The Manager's Statement



I am pleased that we led the way with the first large power income fund in Canada. I would like to take this opportunity to thank you for your investment in the Northland Power Income Fund. Your confidence in our ability to deliver the performance you expect at the Iroquois Falls Facility has made the Fund a major success.

I would also like to thank our customers and long-term suppliers for their support; and to acknowledge the contributions of the Facility's operations and maintenance team, Northland Power's design and administrative team, IFPC's Board of Directors, and the many contractors, consultants, and other suppliers who worked diligently to ensure the outstanding performance of the Facility throughout 1997.

On behalf of the administrator of the Fund and the Manager of the Facility.

A handwritten signature in black ink, appearing to read "J. Temerty".

James C. Temerty, President
Iroquois Falls Power Management Inc.

Industry Overview

THE ONTARIO ELECTRICITY INDUSTRY

In November of 1997, the Government of Ontario released its White Paper, "Direction for Change: Charting the Course for Competitive Electricity and Jobs in Ontario". This paper proposed the creation of a competitive electricity market for both wholesale and retail customers by the year 2000.

The first step in the creation of a competitive market occurred on January 16, 1998, when the Government of Ontario and Ontario Hydro announced the creation of an interim competitive supply market. This interim market will allow competition for the replacement of electricity from Ontario Hydro's planned shutdown of nuclear reactors until full open competition is achieved. Currently, there is a surplus of electricity production capacity in Ontario and the northeastern United States, so the pricing in the interim market is likely to reflect marginal costs. At present, opportunities for the Facility to participate in the interim market are being pursued.

*Northland Power
is a great example
of a 21st century
company.*

*Northland Power
is creating quality,
long-term jobs
here in the north
and throughout
Ontario.*

*– The Honourable Chris Hodgson,
Minister of Natural Resources,
Northern Development and Mines*





Industry Overview

When full competition begins, Ontario Hydro's transmission grid and the wires for the province's entire electricity distribution system will become available to all generators, including those outside Ontario. All customers will have access to competitive suppliers. The market price will have to allow for the recovery of all production, financing, environmental and other costs if suppliers are to build new capacity. It will be imperative that all power producers make their operations as efficient as possible to remain competitive.

Opportunities that may arise for the Facility to generate incremental electricity sales will be assessed while ensuring that the Fund's revenue continues to be underpinned by the existing long-term power purchase agreement in place with Ontario Hydro.



Iroquois Falls



*Steam line to
Abitibi-Consolidated Inc.
mill*

***Four years ago,
the future of our
town was uncertain.
Through the
persistence and
dedication of the
people at Northland
Power and their
partnership
with Abitibi-
Consolidated and
Ontario Hydro, we
now see a bright
future and secure
employment.***

– Ken Graham, Mayor, Iroquois Falls

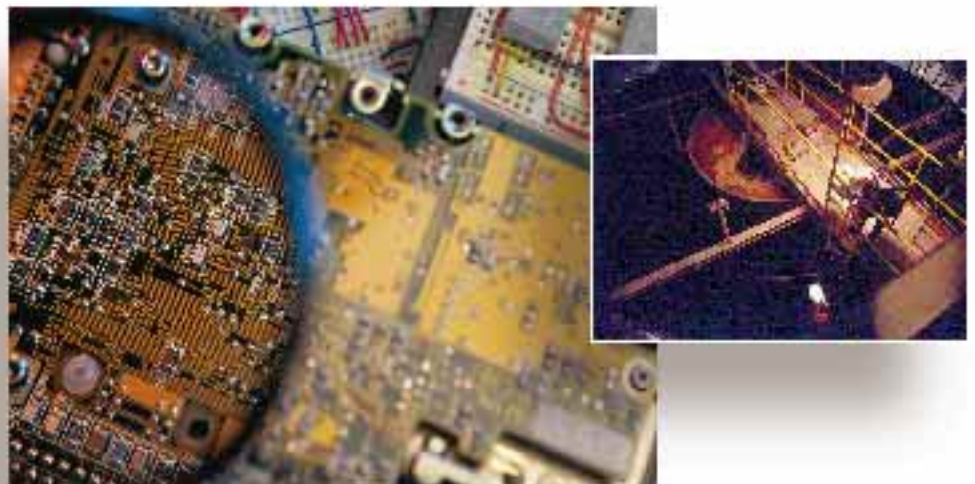
REPORT ON OPERATIONS

Northland Power Income Fund's main assets are the Iroquois Falls cogeneration Facility and its contracts with Ontario Hydro, Abitibi-Consolidated Inc., gas suppliers and transporters, and General Electric Canada Inc.

The Facility is a combined-cycle cogeneration plant, with a net rated capacity of 110 MW of electrical output. Aside from any gas sales, approximately 90 per cent of the Facility's revenue comes from electricity sales to Ontario Hydro. The remaining 10 per cent is from steam sales to the neighbouring Abitibi-Consolidated Inc. pulp and paper mill.

Cogeneration is the simultaneous production of electricity and thermal energy (steam) from one fuel source. In conventional electricity production, as little as 30 per cent of the fuel energy is captured, while 70 per cent is wasted. By producing electricity and steam together, cogeneration can improve the total thermal efficiency dramatically, to as high as 85 per cent. Burning less fuel not only lowers costs, it helps the environment by reducing greenhouse gas production, and using natural gas as the fuel virtually eliminates sulphur dioxide emissions.

The first fiscal period for the Fund included operations for the nine months from April 1 to December 31, 1997. During this period, electricity production was within 0.1 per cent of the 517,700 MWh forecast in the prospectus (the "Forecast"). Steam production was approximately 8 per cent higher than the forecasted 715 million pounds. Sales of \$38,691 thousand exceeded the Forecast primarily because \$1,561 thousand was received for natural gas that was resold to mitigate the cost of unused transportation capacity.



Iroquois Falls



Cash Distributions per Unit:
The empty slice in the pie chart represents a distribution of 32¢ per unit which was declared subsequent to year end for the 1st Quarter of 1998. This brought total distributions for the first 12 months of the Fund's operations to 92¢ per unit. Distributions are uneven through the year due to seasonality in revenues which arises from higher production and selling prices in winter.

Northland Power has proven to be a company that is in it for the long haul. They are continually improving and growing, providing me with the opportunity to grow with them.

— Albert Willis, Operations Coordinator, Iroquois Falls Power Corp.

The cost of sales at \$15,090 thousand was higher than the Forecast of \$13,697 thousand mainly because \$1,226 thousand of gas was purchased for resale. Gas consumption was approximately 5 per cent above the Forecast while the price was below the Forecast. The net impact of the higher sales and cost of sales was that the gross profit of \$23,601 thousand exceeded the Forecast of \$23,322 thousand.

Plant operating and other costs were consistent with the Forecast except for the higher interest cost on the instalment receipt loan which was due to a higher than expected interest rate. Net income fell short of the Forecast by \$466 thousand because of these interest costs, but this had no impact on distributions as the purchase price for the Facility was reduced to compensate for the higher interest rate. Distributions to unitholders of \$0.60 per unit were also on target with the Forecast.

The Facility has the capacity to produce an annual average of 15 per cent more electricity than the Forecast provided. Ontario Hydro's interim supply market may provide some opportunities to sell this power in the short term. When the market is deregulated, market prices are expected to reflect total production costs as compared to the marginal costs currently being encountered in the interim market. Opportunities that may arise will be assessed.

Subsequent to December 31, 1997 the employees at the Facility voted to join the International Union of Operating Engineers. The union certification is not expected to have a material impact on the operations at the Facility or the distributions to unitholders.

On April 15, 1998, the Fund received the proceeds of the second instalment of \$4 per unit, and the instalment receipt loan in the amount of \$123.3 million, including interest, was repaid.



Northland Power Income Fund



FUND STRUCTURE

The Fund directly owns the generating assets of the Iroquois Falls Facility (the "Facility Equipment") and indirectly owns the balance of the Facility and the Facility contracts through its ownership of 100 per cent of the common shares of Iroquois Falls Power Corp. ("IFPC"). The Fund has a loan of \$45 million outstanding to IFPC and leases the Facility Equipment to IFPC under a lease agreement that expires in 2022 (the "Facility Lease").



The Fund earns income from IFPC through rental payments under the Facility Lease, interest on the loan, and dividends on the shares, and receives any capital distributions made by IFPC. The Fund's policy is to distribute all available cash to its unitholders on a quarterly basis subject to maintaining reasonable reserves for working capital and capital expenditures.

Northland Power Income Fund



Governance

As Trustee, Montreal Trust Company of Canada has responsibility for the administration of the Fund. The Trustee has delegated administrative responsibility to Iroquois Falls Power Management Inc. (the “Manager”) under an administration agreement.

The Board of Directors of IFPC has responsibility for supervising the management of the Facility, the administration of the contracts, and the operation of the business of selling electricity and steam. The Board consists of five directors, four of whom are independent of the Manager. The Board has delegated the day-to-day management responsibilities in respect of IFPC to the Manager under a management agreement expiring in 2021. The Board of IFPC advises the Manager in regard to certain functions of the Manager in relation to the Fund.

Taxation

Fund distributions to unitholders are expected to be largely non-taxable for several years because the Fund’s capital cost allowance and expenses significantly reduce the Fund’s income that would otherwise be taxable. The non-taxable portion of distributions represents a return of capital for income tax purposes, and will reduce the adjusted cost base of the trust units.

Generally, a trust unit is considered to be capital property. The actual or deemed disposition of a unit will give rise to a capital gain (or loss) equal to the amount by which the proceeds of disposition of a unit are greater (or less) than the adjusted cost base of the unit and any associated selling expenses.

Leading Power Company



*Cochrane generating station,
42MW, 1989*



*Kirkland Lake generating station,
104MW, 1990*

NORTHLAND POWER INC.

The administrator of the Fund and the manager of the Facility is Iroquois Falls Power Management Inc., a wholly owned subsidiary of Northland Power Inc. ("Northland Power").

Northland Power is a leading Canadian independent power company with extensive experience in developing, engineering, financing, operating and maintaining private power projects. Northland Power has earned a reputation for flexibility, responsiveness, innovation and reliability through the success of its projects.

Headquartered in Toronto, Northland Power and its engineering subsidiary, COGENERATION Associates, are equipped to take complete control of any power project from initial concept, through financing and construction, to long-term operations. Northland Power's Calgary office buys and sells natural gas, arranges supply contracts, and coordinates pipeline capacity for the plants managed by Northland Power and its subsidiaries, as well as for third parties.

Northland Power and its subsidiaries operate three power facilities in Canada and one in Ukraine.

The 42 MW Cochrane, Ontario generating station, commissioned in 1989, has consistently demonstrated availability in excess of 95 per cent. It was built in two stages. The first stage included the installation of a specially designed grate and boiler that allow the plant to efficiently burn wood waste products without the need for pre-processing. The reduced capital and operating costs result in some of the lowest-cost wood-based generation anywhere. The second stage of the Cochrane station was the installation of a natural gas fired combustion turbine. The plant is designed to supply steam to a neighbouring sawmill and plywood mill.



Leading Power Company



*Iroquois Falls generating station,
110MW, 1996*



*Darnytsia heat and power station,
Kyiv, Ukraine
280MW*

Northland Power has a proven record of delivering strong financial results in projects it manages. Northland's capabilities in finding opportunities, designing, building, operating and maintaining facilities have proven to be extremely effective over the years.

***– Stephen Probyn, President & CEO,
Canadian Environment Energy Corporation,
Kirkland Lake Power Corp.,
Cochrane Power Corporation***

The 104 MW Kirkland Lake, Ontario generating station began operation in 1990. This facility, the first combined-cycle, integrated fuels generating plant in the world, burns wood residues and natural gas. Engineered, procured and contracted for construction by Northland Power, the Kirkland Lake plant produced its first power only nine months after ground breaking, a practical demonstration of some of the key benefits of independent power facilities - flexibility and responsiveness to the energy needs of local markets.

The 110 MW Iroquois Falls Facility, now owned by the Fund and IFPC, was commissioned in 1996. The plant consists of state-of-the-art equipment including two General Electric LM6000 gas turbine generator sets, two Babcock & Wilcox heat recovery steam generators with duct burners, and a General Electric steam turbine generator set. The Facility supplies up to 300,000 lbs. per hour of steam to the neighbouring Abitibi-Consolidated Inc. pulp and paper mill and is one of the most efficient, large cogenerating stations in Canada. Availability has been approximately 97 per cent since startup.

In 1997, a subsidiary of Northland Power signed an agreement with Government of Ukraine entities and others providing Northland Power with majority control of the Darnytsia combined heat and power station in Kyiv, Ukraine. Northland Power will manage the plant and its re-powering. The refurbished plant will incorporate modern gas turbine and heat recovery steam generation technology. When completed, the project will supply up to 280 MW of peaking power to the Ukraine electrical grid and up to 640 MW of thermal energy as district heat for 300,000 people and steam for industry. In addition, the modernization program will reduce emissions from the plant.



Management's Discussion and Analysis

NORTHLAND POWER INCOME FUND

Northland Power Income Fund (the "Fund") was established in 1997. The Fund is an unincorporated, open-ended trust that derives its distributable cash from Iroquois Falls Power Corp. ("IFPC"), a special purpose corporation wholly-owned by the Fund.

Effective April 1, 1997, the Fund and IFPC purchased the Iroquois Falls cogeneration facility (the "Facility") for a total cash consideration of \$283.7 million. Under a prospectus dated April 3, 1997 the Fund qualified the distribution and sale of 30,823,443 trust units on an instalment receipt basis. Of the total unit price of \$10 each, the first instalment of \$6 was paid on April 15, 1997 and the final instalment of \$4 per unit is payable on April 15, 1998. After deducting costs of \$18.1 million, the net proceeds from the sale of the trust units was \$290.2 million.

This Management Discussion and Analysis compares the Fund's financial results from operations for the nine months commencing April 1, 1997, when IFPC received rights to the Facility's cash flow, and ending December 31, 1997, to the Consolidated Financial Forecast for the same period (the "Forecast") contained in the prospectus.

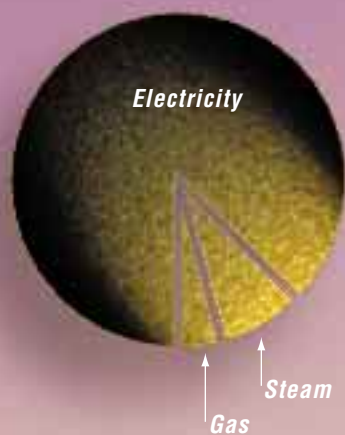
CONSOLIDATED STATEMENT OF INCOME AND COMPARISON TO FORECAST

For the Nine Month Period of Operations Ended December 31, 1997

	Actual	Forecast
	(\$'000s)	
Sales	\$ 38,691	\$ 37,019
Cost of sales	15,090	13,697
Gross profit	<u>23,601</u>	<u>23,322</u>
Expenses		
Plant operating costs	4,076	3,397
Amortization	6,922	7,675
Management & administration costs and capital tax	924	683
Instalment loan interest & bank fees	4,629	3,982
Other interest (income)	(209)	19
	<u>16,342</u>	<u>15,756</u>
Provision for income taxes		
Current	98	169
Deferred	85	(145)
	<u>183</u>	<u>24</u>
Net Income	<u>\$ 7,076</u>	<u>\$ 7,542</u>

Net income fell short of the Forecast because a higher than anticipated interest rate on the instalment receipt loan increased interest costs; however, this did not affect distributions to unitholders because the actual purchase price for the Facility was reduced by a corresponding amount. Comments on other variances from the Forecast are provided below.

Management's Discussion and Analysis



Revenue

REVENUE AND COST OF SALES

	Actual	Forecast
	(\$'000s except as specified)	
Electricity		
Production (MWh)	517,058	517,653
Price (\$/kWh)	0.0659	0.0658
Sales	34,063	34,061
Steam		
Production ('000 lbs.)	769,833	714,841
Price (\$/'000 lbs.)	3.98	4.14
Sales	3,067	2,958
Sales, other	1,561	0
Sales, total	\$ 38,691	\$ 37,019
Cost of Sales: Natural Gas		
Consumption ('000 GJ)	4,942	4,728
Price of gas consumed (\$/GJ)	2.81	2.90
Cost of gas consumed	13,864	13,697
Gas purchased for resale	1,226	0
Cost of Sales	\$ 15,090	\$ 13,697

Electricity production, price, and sales revenue were all within 0.2 per cent of the Forecast. Steam production exceeded expectations by 7.7 per cent because of Abitibi-Consolidated Inc.'s increased demand on the Facility. The steam selling price was down 3.9 per cent from the Forecast as it is tied to the price of natural gas which was lower than forecast.

Other sales of \$1,561 thousand represent natural gas resold to mitigate the cost of unused capacity under the transportation contract with TransCanada Pipelines Limited ("TCPL") during lower production summer months and outage periods.

Natural gas consumption exceeded the Forecast by 4.5 per cent because higher than forecast steam demand and unexpectedly large variations in that demand caused the Facility to operate less efficiently than had been anticipated. The price of gas consumed was down from the Forecast due mainly to an unanticipated reduction in the TCPL tariff. Gas purchased for resale to make use of unused TCPL pipeline capacity cost \$1,226 thousand; its sale generated a gross profit of \$335 thousand in addition to recovered fixed transportation costs.

COSTS

Plant operating costs of \$4,076 thousand exceeded the Forecast by \$679 thousand and amortization was below the Forecast by \$753 thousand primarily because the amortization of the deferred maintenance contract fee of \$819 thousand was included in plant operating costs in the actual results, and in amortization expense in the Forecast. General and administration costs exceeded the Forecast because first year organizational activities were more costly than expected.

The instalment loan interest was higher than the Forecast because the actual interest rate exceeded the rate forecasted. The purchase price for the Facility of \$283.7 million was lower than the \$284.8 million provided in the prospectus to offset the higher interest cost. As a result, distributions to unitholders were not affected by the interest cost overage.

Management's Discussion and Analysis

CASH FROM OPERATIONS AND DISTRIBUTIONS TO UNITHOLDERS

	Actual	Forecast
	(\$'000s)	
Net Income	\$ 7,076	\$ 7,542
Plus/(minus):		
Amortization	6,922	7,675
Deferred maintenance fee amortization	819	0
Instalment loan, interest accrued & bank fees amortized	4,629	3,982
Deferred income taxes	85	(145)
Funds from operations, before working capital changes	19,531	19,054
Changes in non-cash operating working capital	(1,558)	(441)
Capital expenditures, net of restricted cash used	0	(75)
Cash from operations after capital expenditures	\$ 17,973	\$ 18,538
Distributions declared to unitholders	\$ 18,494	\$ 18,538
		('000s)
Number of Trust Units	30,823	30,823
Per unit		(\$/unit)
Funds from operations, before working capital changes	\$ 0.63	\$ 0.62
Cash available for distribution	\$ 0.58	\$ 0.60
Distribution declared to unitholders	\$ 0.60	\$ 0.60

While funds from operations before working capital changes exceeded the Forecast, unplanned working capital changes caused cash from operations to fall short of the Forecast. As these unplanned working capital changes do not represent permanent working capital, distributions to unitholders were declared at essentially the level included in the Forecast.

CAPITAL STRUCTURE AND LIQUIDITY

In 1997 an initial public offering of 30,823,443 trust units at \$10 per unit yielded proceeds of \$308.2 million before issue costs, and \$290.2 million after costs. The initial instalment of \$6 per unit was paid April 15, 1997. The final instalment of \$4 per unit is due by April 15, 1998.

An instalment receipt loan for an original principal amount of \$116.8 million plus accumulated interest is due to be repaid from the \$4 per unit proceeds of the second instalment receipt by April 16, 1998. The Fund's subsidiary, Iroquois Falls Power Corp. ("IFPC"), has a line of credit of \$17.5 million consisting of a \$7.5 million revolving letter of credit facility and a \$10 million revolving operating line of credit to be used for general corporate purposes. At December 31, 1997, a letter of credit for \$5.9 million was outstanding; there were no borrowings under the operating line of credit. The Fund's instalment receipt loan and IFPC's line of credit are secured by the assets of the Fund and IFPC. After repayment of the instalment receipt loan on April 16, 1998 the Fund will be financed by equity and the line of credit.

The Fund's policy is for IFPC to pay for normal capital expenditures from cash flow. Material capital expenditures that enhance cash flow and ultimately distributions to unitholders will be financed using the operating line of credit which will then be repaid from incremental cash flow. Acquisitions, if any, will be undertaken only if approved by the IFPC Board of Directors who will need to be satisfied that the required capital could be

Management's Discussion and Analysis

raised and that it would be in the best interests of the unitholders to do so. The issuance of additional units of the Fund is subject to prior approval by the unitholders.

SEASONALITY OF DISTRIBUTIONS

The Fund's distributions are seasonal as Ontario Hydro has contracted for more electricity and pays a higher price in winter than in summer. In addition, steam sales to Abitibi-Consolidated Inc. are anticipated to be higher in winter. Distributions to unitholders reflect this seasonality and the impact of the approximate one month delay in collecting receivables and paying suppliers.

COMMITMENTS

The Facility generates electricity and sells it to Ontario Hydro under a power purchase agreement expiring in 2021. It obligates Ontario Hydro to purchase quantities of electricity ranging from a monthly average of 75 megawatts (MW) in the summer months to 96 MW in the winter (the yearly average is approximately 85 MW). The Facility supplies steam to the neighbouring Abitibi-Consolidated Inc. pulp and paper mill under a steam sales agreement that terminates in 2016.

The Facility is fueled by natural gas provided by PanCanadian Petroleum Limited, Coral Energy (formerly Shell Canada Limited), and Encal Energy Ltd. pursuant to gas supply contracts that end at various times between 2015 and 2017. The gas is transported through pipelines owned by TCPL and Union Gas Limited from western Canada to the plant site under firm service agreements that run to 2016. The maintenance of the two LM 6000 gas turbines is contracted to General Electric Canada Inc. ("GE") under a maintenance agreement that expires in 2002 and is renewable at IFPC's option under similar terms.

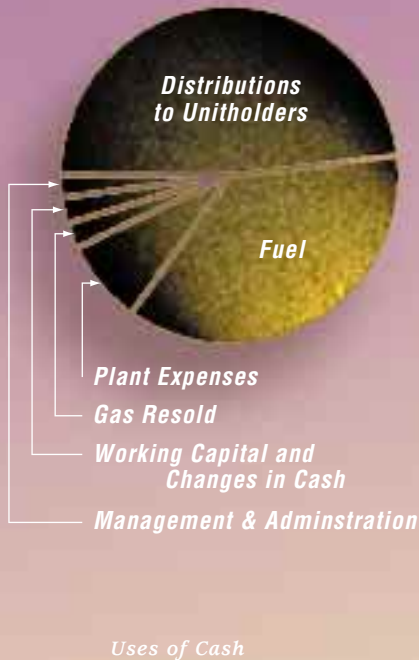
The Facility is operated by Iroquois Falls Power Management Inc., a wholly owned subsidiary of Northland Power Inc., under a Management Agreement expiring in 2021. The Administrator of the Fund is Iroquois Falls Power Management Inc. under the Administration Agreement.

RISKS AND UNCERTAINTIES

The amount distributed by the Fund to unitholders is highly dependent upon the parties to the Fund's long-term contracts continuing to fulfill their contractual obligations. In particular, as electricity sales represent 90 per cent of the Fund's revenues, failure of Ontario Hydro to meet its contractual obligations would have an adverse affect on distributions.

Approximately 77 per cent of the Fund's revenue from electricity sales to Ontario Hydro fluctuates with changes in Ontario Hydro's rates to its customers. The remaining 23 per cent of the Fund's electricity revenue and its gas commodity costs escalate with Ontario Hydro's customer rates, subject to specified minimum escalation rates. Ontario Hydro's customer rates have not changed appreciably since 1993 and it is the policy of the Government of Ontario that the customer rates remain frozen until 2000. The impact of a competitive marketplace announced in the government of Ontario's White Paper, dated November 6, 1997, and which is to become effective in 2000, is not known. At present, the Facility holds a long-term power purchase agreement with Ontario Hydro which the Manager expects to continue in force after market deregulation.

Abitibi-Consolidated Inc.'s demand for steam is determined by operations at its pulp and paper mill, including the level of its own steam production. The Facility is obliged to respond to fluctuations in Abitibi-Consolidated Inc.'s steam needs. Demand for steam has an impact on gas consumption, and



Uses of Cash

Management's Discussion and Analysis

unexpectedly large short-term fluctuations in steam demand increase gas consumption without an offsetting increase in steam revenue.

Any failure by TCPL or Union Gas Limited to deliver natural gas to the Facility will have an adverse effect on cash distributions.

The Fund is subject to operational risks which could have an adverse impact on cash distributions. These risks are partially mitigated by the proven nature of the technology and design of the Facility, the availability of critical spares on site, the gas turbine maintenance agreement with GE, and participation in the GE gas turbine lease pool which guarantees the availability of replacement gas turbines on short notice. The Fund has business interruption insurance to help mitigate the impact on distributions of adverse occurrences that are insured.

The Facility operations are subject to numerous environmental laws and regulations. The Facility has an environmental monitoring and reporting system in place. Changes in environmental laws and regulations could possibly result in additional expenses, capital expenditures, and restrictions in the Facility's activities, the extent of which cannot be predicted.

The Fund is reliant upon the Manager for the administration and management of all matters relating to the Facility.

YEAR 2000 SOFTWARE PROBLEM

Certain computer programs and microprocessors use two digits to represent a four digit year as they assume that one and nine are always the first two digits. Such programs may produce erroneous results when required to process dates whose first two digits are not one and nine, such as those for the year 2000 and subsequent years. This is commonly referred to as the "Year 2000 Problem."

Although there can be no guarantee that the systems of other companies on which the Manager's systems rely will be converted on a timely basis, the Manager has developed a plan to approach suppliers and customers to determine the extent to which the Manager may be affected by their failure to address their own year 2000 compliance issues. Their failure to adequately address this issue could conceivably cause a material adverse effect on the Manager's future results of operations.

The Fund, IFPC, and the Manager do not use any custom programs. The Manager is currently undertaking an inventory of all systems to identify software and hardware which is not year 2000 compliant. To date the Manager has determined that it will be required to update certain purchased software; however, nothing has come to the attention of the Manager that indicates that any modifications that are required will have a material adverse effect on the operations of the Facility or the Fund. The Manager will continue to take actions to ensure that year 2000 compliant versions are installed by December 31, 1998. The costs of such modifications and replacements is not currently anticipated to be material. Costs related to any hardware and software modifications will be expensed as incurred.

OUTLOOK

The prospectus dated April 3, 1997 forecast cash distributions of \$0.934 per unit for the year ended December 31, 1998. At this time, the Manager expects that the Fund will achieve this forecast.

The Facility has excess capacity which is available for sale to the interim market established by Ontario Hydro. The Fund expects to submit bids to the interim market. The Manager's opinion is that the impact of any successful bids on distributions is likely to be minimal. In the longer term, with the establishment of a competitive marketplace, the Manager will assess opportunities that may arise.

Consolidated Financial Statements
NORTHLAND POWER INCOME FUND
December 31, 1997

Auditor's Report

To the Unitholders of
Northland Power Income Fund

We have audited the consolidated balance sheet of **Northland Power Income Fund** as at December 31, 1997 and the consolidated statements of income and deficit and cash flows for the period from inception on February 17, 1997 to December 31, 1997. These financial statements are the responsibility of the Manager of the Fund. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Fund as at December 31, 1997 and the results of its operations and the changes in its financial position for the period from inception on February 17, 1997 to December 31, 1997 in accordance with generally accepted accounting principles.



Toronto, Canada,
March 6, 1998.

Ernst & Young
Chartered Accountants

Northland Power Income Fund

CONSOLIDATED BALANCE SHEET

[in thousands of dollars]

As at December 31, 1997

\$

ASSETS

Current [note 7]

Cash and term deposits	7,185
Restricted cash [note 1]	682
Accounts receivable [note 3]	6,200
Instalment receivable [note 4]	123,294
Inventories [note 5]	1,401
Prepaid expenses	679
Total current assets	139,441
Deferred maintenance fee, net	5,181
Capital assets, net [notes 6 and 7]	266,720
	411,342

LIABILITIES AND UNITHOLDERS' EQUITY

Current

Accounts payable and accrued liabilities	3,197
Income taxes payable	98
Instalment loan payable, including interest [note 7]	121,522
Distribution payable to Unitholders	7,706
Total current liabilities	132,523
Deferred income taxes	85
Total liabilities	132,608

Commitments [note 12]

Unitholders' equity

Unit capital [note 8]	290,152
Deficit	(11,418)
Total Unitholders' equity	278,734
	411,342

See accompanying notes

Approved on behalf of the Northland Power Income Fund
by Iroquois Falls Power Management Inc.



James C. Temerty
President

Northland Power Income Fund

CONSOLIDATED STATEMENT OF INCOME AND DEFICIT

[in thousands of dollars]

Period from inception on February 17, 1997 to December 31, 1997

	\$
Sales	38,691
Cost of sales	15,090
Gross profit	23,601
Expenses	
Plant operating costs	4,076
Amortization	6,922
Management and administrative costs <i>[note 10]</i>	924
Instalment loan, interest expense and bank fees	4,629
Other interest income	(209)
	16,342
Income before income taxes	7,259
Provision for income taxes <i>[note 11]</i>	
Current	98
Deferred	85
	183
Net income for the period	7,076
Retained earnings, beginning at inception	—
Distributions to Unitholders	(18,494)
Deficit, end of period	(11,418)
Net income per Trust Unit <i>[note 2]</i>	\$0.23

See accompanying notes

Northland Power Income Fund

CONSOLIDATED STATEMENT OF CASH FLOWS

[in thousands of dollars]

Period from inception on February 17, 1997 to December 31, 1997

\$

OPERATING ACTIVITIES

Net income for the period	7,076
Add items not involving a current outlay of cash	
Amortization	6,922
Deferred maintenance fee amortization	819
Instalment loan, interest expense accrued and bank fees amortization	4,629
Deferred income taxes	85
Funds from operations before changes in working capital	19,531
Net change in non-cash working capital balances related to operations	(1,558)
Cash provided by operating activities	17,973

INVESTING ACTIVITIES

Purchase of Iroquois Falls Facility [including restricted cash of \$1,938] [note 1]	(283,660)
Cash used in investing activities	(283,660)

FINANCING ACTIVITIES

First instalment proceeds on issuance of Trust Units	166,858
Advances on instalment loan, net of bank fees	116,802
Distribution payable to Unitholders	7,706
Distributions to Unitholders	(18,494)
Cash provided by financing activities	272,872

Net increase in cash during the period, and cash and term deposits, end of period	7,185
--	--------------

See accompanying notes

Notes to Consolidated Financial Statements

NORTHLAND POWER INCOME FUND

December 31, 1997

1. DESCRIPTION OF BUSINESS

Northland Power Income Fund [the "Fund"] was established under the laws of the Province of Ontario pursuant to a Declaration of Trust dated February 17, 1997, as amended April 15, 1997, as an unincorporated open-ended trust. The Fund derives its distributable cash flow from Iroquois Falls Power Corp. ["IFPC"], a special purpose corporation, wholly-owned by the Fund.

Effective April 1, 1997, the Fund and IFPC purchased the Iroquois Falls cogeneration power facility [the "Facility"], located in Iroquois Falls, Ontario for total cash consideration of \$283,660,000. The acquisition of the Facility has been accounted for using the purchase method and results of operations have been included in these consolidated financial statements from April 1, 1997. Under a prospectus dated April 3, 1997, the Fund qualified the distribution and sale of 30,823,443 Trust Units on an instalment receipt basis. Of the total unit price of \$10 each, the final instalment of \$4 per Unit is payable on April 15, 1998. The net proceeds from the sale of the Units was \$290,152,000 after deducting underwriters' fees and other issue costs of \$18,082,000.

The fair values assigned to the identifiable assets acquired were as follows:

	\$
	[000's]
Facility equipment, real estate and contracts	272,895
Deferred maintenance fees	6,000
Current assets [including restricted cash of \$1,938]*	7,853
Current liabilities	(3,088)
Net assets acquired	283,660

* At December 31, 1997, the restricted cash balance is \$682,000. The restricted cash used for the period ended December 31, 1997 is as follows:

	\$
	[000's]
Purchase of capital assets	747
Purchase of spares inventory	71
Reduction of contractor holdback payable	438
Total restricted cash used	1,256

The Facility produces electricity for sale exclusively to Ontario Hydro under the provisions of a contract expiring in 2021 and steam for sale to Abitibi-Consolidated Inc. under the provisions of a contract expiring in 2016.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in Canada. The preparation of

financial statements requires that Iroquois Falls Power Management Inc. [the "Manager"], the administrator of the Fund and the manager of the Facility, 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 consolidated financial statements, and revenue and expenses during the reporting period. Actual results could differ from these estimates.

Principles of consolidation

These consolidated financial statements include the accounts of the Fund and the accounts of IFPC. All inter-entity transactions have been eliminated.

Cash and term deposits

Term deposits consist mainly of interest bearing term deposits with maturity dates of less than 90 days. The weighted average interest rate on term deposits held as at December 31, 1997 approximates 3.9% per annum.

Inventory

Inventory largely comprises natural gas and spare parts. Natural gas is carried at the lower of cost, as determined on a weighted average basis and net realizable value. Spare parts and other inventory is carried at the lower of cost, on a first-in, first-out basis, and net replacement cost.

Capital assets

Capital assets are recorded at cost less accumulated amortization. Amortization is provided at rates designed to amortize the cost of the assets over their estimated useful lives as follows:

Buildings and foundations	30 years straight-line
Plant and equipment	30 years straight-line
Furniture and fixtures	5 years straight-line
Vehicles	5 years straight-line
Computers and computer software	2 years straight-line
Contracts [note 3]	over the term of the agreements

Deferred maintenance fee

The deferred maintenance fee is amortized over the term of an agreement between IFPC and General Electric Canada Inc. for the maintenance of the gas turbines. This agreement expires in 2002 and is renewable upon expiry.

Revenue recognition

Revenue is recognized upon the delivery of electricity to Ontario Hydro and steam to Abitibi-Consolidated Inc.

Income taxes

Under the terms of the Income Tax Act (Canada), the Fund is not subject to income taxes to the extent that

Notes to Consolidated Financial Statements

NORTHLAND POWER INCOME FUND

December 31, 1997

its taxable income in a year is paid or payable to a unitholder. The Fund's wholly-owned subsidiary, IFPC, is subject to corporate income taxes as computed under the Income Tax Act (Canada). The deferred tax allocation method of providing for income taxes has been applied to IFPC.

Net income per Trust Unit

Net income per Trust Unit is based on the consolidated net income for the period over the weighted average number of Trust Units outstanding during the period, which was 30,823,443.

3. ECONOMIC DEPENDENCE AND CONCENTRATION OF CREDIT RISK

The Fund is entirely dependent on the facility lease income, interest income and dividends received from IFPC. In 1997, approximately 88% of IFPC's revenues are derived from the sale of electricity to Ontario Hydro [pursuant to a contract expiring in 2021] and approximately 8% of IFPC's revenues are derived from the sale of steam to Abitibi-Consolidated Inc. [pursuant to a contract expiring in 2016].

Approximately 87% of the period-end accounts receivable balance is due from Ontario Hydro relating to electricity sales.

4. INSTALMENT RECEIVABLE

The instalment receivable represents the second instalment due from Unitholders to the Fund for the purchase of their Units. An initial instalment of \$6 per Trust Unit was paid on April 15, 1997 and the final instalment of \$4 per Trust Unit is due no later than April 15, 1998. Until the final instalment is paid, the Trust Units are pledged to the Fund to secure the obligation to pay the final instalment. The proceeds from the final instalment will be used to pay the instalment receipt loan payable [note 7].

At December 31, 1997, the fair value of the instalment receivable approximates its carrying value.

5. INVENTORIES

Inventories consist of the following at December 31, 1997:

	\$
	[000's]
Natural gas and other inventory	678
Spare parts	723
	1,401

6. CAPITAL ASSETS

Capital assets consist of the following:

	December 31, 1997		
	Cost	Accumulated amortization	Net book value
	\$	\$	\$
	[000's]		
Land	126	—	126
Buildings and foundations	23,112	577	22,535
Plant and equipment	236,627	5,907	230,720
Contracts	13,668	410	13,258
Vehicles	19	3	16
Office equipment, furniture and fixtures	35	4	31
Computers and computer software	55	21	34
	273,642	6,922	266,720

7. INSTALMENT LOAN PAYABLE

On April 15, 1997, a credit agreement was entered into with the Canadian Imperial Bank of Commerce, as agent for a syndicate of banks. Pursuant to this agreement the Fund borrowed \$116,802,000 [net of bank fees of \$317,000] which bears interest at 5.26% per annum. Interest and principal repayments are due at maturity on April 16, 1998.

The credit agreement also establishes a \$7.5 million revolving, term letter of credit facility to be used in meeting obligations under gas transportation and supply contracts and a \$10 million revolving, term operating line of credit for general corporate purposes. Interest per annum under the operating line of credit agreements is the greater of [i] prime rate and [ii] the sum of CDOR [bankers' acceptance discount rate] plus 1.0%. Fees of 0.875% per annum on the amount and term of letter of credits are charged. Standby fees of 0.375% are charged on each of the undrawn letter of credit and operating line facilities.

At December 31, 1997, a letter of credit for \$5.9 million is outstanding under the letter of credit facility and no amounts have been drawn on the operating line.

Amounts drawn under the credit agreement are principally collateralized by a debenture security and by general security agreements which constitute a first priority lien on all of the real property and all of the present and future property assets of IFPC and the Fund, as well as a pledge by the Fund of its current and future interests in the capital stock of IFPC, the IFPC notes and all other securities issued by IFPC.

Notes to Consolidated Financial Statements

NORTHLAND POWER INCOME FUND

December 31, 1997

8. UNITHOLDERS' EQUITY

The Trustee may issue an unlimited number of Trust Units [subject to Unitholder approval]. Each Trust Unit represents an equal fractional beneficial interest in the Fund. All Trust Units are transferable and share equally in all distributions from the Fund whether of net income, return of capital, return of principal, interest, dividends or net realized capital gains or other amounts, and in the net assets of the Fund in the event of termination or winding up of the Fund.

	\$
Issued and outstanding	
30,823,443 Trust Units	290,152,000

The Trust Units are redeemable at any time on demand by the holders at their fair value, determined as the lesser of: [i] 95% of the "market price" of the Trust Units on the principal market on which the Trust Units are quoted for trading during the 10 trading day period commencing immediately after the date on which the Trust Units are surrendered for redemption; and, [ii] the "closing market price" on the principal market on which the Trust Units are quoted for trading on the date that the Trust Units are surrendered for redemption.

The aggregate redemption price payable by the Fund in respect of any Trust Units surrendered for redemption during any calendar month shall be satisfied by way of a cash payment on the last day of the following month; provided that the entitlement of Unitholders to receive cash upon redemption of their Trust Units is subject to the limitations that [i] the total amount payable by the Fund in respect of such Trust Units and all other Trust Units tendered for redemption in the same calendar month shall not exceed \$200,000, [ii] at the time such Trust Units are tendered for redemption the outstanding Trust Units of the Fund shall be listed for trading on a stock exchange or traded or quoted on any other market which IFPC's Directors consider, in their sole discretion, provides representative fair market value prices for the Trust Units, or [iii] the normal trading of Trust Units is not suspended or halted on any stock exchange on which the Trust Units are listed on the date that the Trust Units are tendered for redemption or for more than five trading days during the ten day trading period commencing immediately after the date on which the Trust Units are tendered for redemption.

9. DISTRIBUTION TO UNITHOLDERS

Cash available for distribution as defined in the Trust Indenture for the period ended December 31, 1997 was \$0.58 per Unit, being an aggregate amount of \$17,973,000.

A \$0.60 per Unit distribution, being an aggregate distribution of \$18,494,000, was determined by the Manager [on behalf of the Trustee] of the Fund for the period ended December 31, 1997. For income tax purposes, the distribution is a return of capital.

10. MANAGEMENT FEE

Iroquois Falls Power Management Inc., as the Manager, is entitled to receive a fee from the Fund and IFPC for services provided related to the operation, management and administration of the Facility, pursuant to a 25-year management agreement expiring in 2021. The fee is payable on a monthly basis at a rate of 1/12 of \$460,000, adjusted annually with changes to the Consumer Price Index. During the period ended December 31, 1997, the Manager was paid \$345,000.

The Manager is also entitled to receive a management incentive fee equal to 25% of the amount by which annual distributions to the Unitholders exceed \$0.60 per Trust Unit for the period ended December 31, 1997 and \$0.934 per Trust Unit for any subsequent year. The Manager is also entitled to various other operation-related incentive fees.

11. INCOME AND OTHER TAXES

	1997
	\$
	[000's]
Income before income taxes	7,259
Combined federal and provincial income tax at statutory rate of 44.62%	3,239
Benefit of timing differences not recognized	(3,133)
Large Corporations Tax and other items	77
Provision for income taxes	183

At December 31, 1997, financing expenses and underwriters' fees of \$14,931,000 are deductible by the Fund for income tax purposes on a straight-line basis over the next four years.

12. COMMITMENTS

In the ordinary course of business, IFPC has entered into agreements covering periods expiring in the years 2015-2017 to ensure an adequate supply of natural gas and transportation thereof to the Iroquois Falls facility.

Board of Directors and Officers

*Iroquois Falls Power Corp.
Board of Directors and Officers*

*Front:
Jim Temerty*

*Centre, Left to Right:
David Rounthwaite
Pierre Gloutney*

*Back, Left to Right:
Right Honourable John Turner
Linda Bertoldi
Warren Moysey*



Corporate and Unitholder Information

Principal Office

c/o Iroquois Falls Power Management Inc.
30 St. Clair Avenue West, 17th Floor
Toronto, Ontario M4V 3A2

Trustee

Montreal Trust Company of Canada
151 Front St. West, Suite 605
Toronto, Ontario M5J 2N1
Attention: Corporate Services

Registrar & Transfer Agent

Montreal Trust Company of Canada
151 Front St. West, Suite 605
Toronto, Ontario M5J 2N1
Attention: Stock Transfer Services

Directors & Officers of

Iroquois Falls Power Corp.

James C. Temerty
President
President, Iroquois Falls
Power Management Inc. and
Northland Power Inc.

Pierre R. Gloutney*
Director
President and Chief Executive Officer,
Refco Futures (Canada) Ltd.

A. Warren Moysey*
Director
Company Director

F. David Rounthwaite*
Director
Partner, McCarthy Tétrault

The Right Honourable
John N. Turner, Q.C.
Director
Partner, Miller Thomson

Linda L. Bertoldi
Secretary
Counsel, Borden & Elliot

Legal Counsel

Borden & Elliot
Toronto, Ontario

Auditors

Ernst & Young
Toronto, Ontario

Bank

Canadian Imperial Bank of
Commerce
Main Branch, Commerce Court
Toronto, Ontario M5L 1A2

Trust Units

The trust units are listed on The
Toronto Stock Exchange and trade
under the symbol NPI.UN

Annual Meeting Date and Place

The first annual meeting of
unitholders of Northland Power
Income Fund will be held on
Tuesday, June 16th, 1998 at
11:00 a.m. in the Trinity Ballroom
of the Toronto Marriott - Eaton
Centre, 525 Bay Street, Toronto,
Ontario M5G 2L2

For Investor Information, Contact:

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Iroquois Falls Power
Management Inc.
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E-mail:
Suzanne@northlandpower.ca

* *Member of the Audit Committee*

Design: Trillium Corporate Communications Inc.



**NORTHLAND POWER
INCOME FUND**

Iroquois Falls Power Management Inc.
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