Northland Power Income Fund

Celebrating 10 Years of Sustainability

2006 Annual Report

Investment Objective and Strategy

The Fund's objective is to produce stable and sustainable levels of cash for distribution to Unitholders from assets, businesses and investments related to the production, conversion, transmission, distribution, purchase and sale of electricity and other forms of energy, energy-related projects and fuels. To achieve its objective, the Fund focuses on minimizing costs, utilizes assets efficiently, maintains a strong balance sheet and intends to continue to build on its existing base of high-quality contracted power facilities in order to increase and diversify its cash flow stream and the long-term value of its portfolio.

Fund Profile

Northland Power Income Fund indirectly owns interests in six power generating facilities. Three of these are natural-gas-fired, combined-cycle cogeneration power plants and three are wind farms. Energy produced from these facilities is sold under long-term arrangements, primarily power purchase agreements (PPAs) with creditworthy entities to ensure revenue stability.

The Fund's cogeneration plants efficiently and cleanly produce electricity and steam and provide over 90% of its distributable cash. Two wholly owned projects are in Ontario: the 120 MW Iroquois Falls facility and the 110 MW plant in Kingston. Through its 19% equity ownership in Panda Energy Corp. (PEC) and loan to a PEC subsidiary, the Fund has an interest in the 230 MW Panda-Brandywine cogeneration plant located outside Washington, D.C. Long-term contracts at the cogeneration plants assure the supply and price of natural gas, the Fund's largest cost. The Fund also owns the 54 MW Mont Miller wind farm in the Gaspésie region of Quebec and two wind farms with a total capacity of 21.5 MW in Germany.

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Investing in Sustainability

In 1997, we created Northland Power Income Fund with the goal of providing investors with a higher return than traditional interest-bearing investments. We were pioneers in the Canadian energy sector – orchestrating the first income fund financing for an independent power project and creating one of the first non-resource income funds. From the outset it was our intention that the Fund provide distributions that would be sustainable well into the future.

To achieve this goal, we focus on acquiring and maintaining profitable, safe and dependable power generation facilities and operating them in a socially and environmentally responsible manner. We cooperate closely with customers, partners and communities and take seriously our responsibility as good corporate citizens. All the while, we continue practising prudent financial management.

This approach has served us well. Since the Fund went public in 1997, the average annual compounded return to Unitholders has been 12%. Looking at it another way, an original Unitholder who invested $10.00 would have received almost all of that capital back ($9.42, to be precise) in distributions and still have owned a unit valued at $13.07 as at December 31, 2006.

Corporate Overview

We have taken a new approach this year in our reporting to Unitholders. This annual report comprises primarily the management's discussion and analysis and financial statements and will be distributed to the relatively small number of Unitholders who have requested it. All Unitholders will receive a separate corporate overview brochure that provides a summary of the Fund's achievements since its inception. It describes our strategy for ensuring the long-term sustainability of distributions by building a portfolio of high-quality assets – diversified in both technology and location and secured with long-term contracts providing stability in both revenues and expenses – and maintaining and improving the Fund's facilities to ensure their efficiency and longevity. We believe that this approach enhances our communications with investors, analysts and other interested parties and at the same time will reduce costs.

2006 Performance

In last year's annual report, we described the benefits and growth potential of combined-cycle cogeneration and wind power, and suggested that the Fund would seek additional accretive acquisitions to further diversify its portfolio. In keeping with that strategy, we expanded the Fund's asset base by 33% in 2006, primarily by increasing its ownership interest from 50% to 100% in the 110 MW cogeneration facility in Kingston, Ontario. This strategic investment increased distributable cash per unit by approximately 3%. The $128 million purchase, together with the retirement of a $34 million debt owed, was financed by proceeds from a $175 million subscription receipt offering of 11.56 million trust units priced at $15.15 per unit.

We also diversified the Fund's sources of income, both geographically and by type of fuel source, with the acquisition of the 7.2 MW Kavelstorf and 14.3 MW Eckolstädt wind farms in Germany for an investment of $23 million in April 2006. The electricity generated is sold to regional power utilities at a fixed tariff under the provisions of Germany's renewable energy legislation.

In 2006 revenues and net income from operations were, respectively, $165 million and $34 million. This compared to 2005 revenues of $128 million and net income of $44 million. The increased revenues were due primarily to the acquisition of the balance of the Kingston facility, the purchase of the German wind farms and the contribution of a full year of

earnings from Mont Miller. Net income was affected by the non-cash cost of amortization mainly related to the new acquisitions.

Operating results in 2006 at Iroquois Falls were somewhat below expectations due to lower electricity and natural gas sales, mainly resulting from the decreased supply of natural gas caused by the January 2006 default by a gas supplier. Improvement is expected in 2007 with a full year's availability of gas under the backstop provisions of one of the other contracts. Energy production at Mont Miller also fell short of expectations this year. While the turbines performed well, the wind resource was lower than long-term projections. The variability was within the normal range of expected wind speeds, however, and we expect the facility to achieve its projections in the future. By contrast, the German wind farms exceeded expectations, due mainly to higher-than-forecast wind speeds. The Kingston facility increased sales slightly over 2005.

We raised distributions by $0.03 per unit in 2006, paying out $1.08 per unit in total. For the year, distributable cash was $71 million ($1.19 per trust unit), well above actual distributions of $65 million. The conservative payout ratio helps protect against year-to-year variability in distributable cash and provides us latitude to pursue opportunities to improve and increase the Fund's asset base.

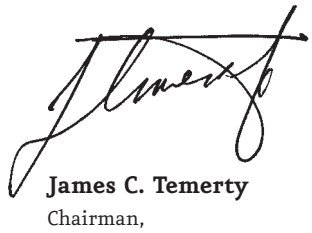
The Fund's assets increased by $182 million in 2006 to $731 million. Long-term debt is a conservative $158 million, providing us with considerable flexibility in financing future transactions and acquisitions. During the year we committed to invest $35 million as a subordinated loan to Northland Power Inc.'s 236 MW Thorold cogeneration plant from the Fund's existing credit facilities. With an interest rate well in excess of the Fund's cost of capital, this transaction will be accretive to Unitholders and provide an opportunity to acquire the entire project through a right of first offer should Northland Power Inc. decide to sell its interest in the future.

Proposed Taxation of Income Trusts

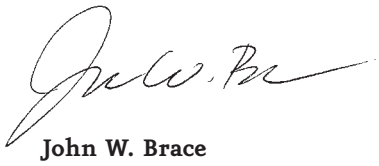
The federal government proposed major changes to the taxation of income trusts on October 31, 2006. The announcement caused an immediate drop in the Fund's unit price of over 20%. While we respect the goals of the Minister of Finance to ensure tax fairness and stem the inappropriate conversion of corporations to the trust structure, we do not agree with his solution or his refusal to consider alternatives. Quite simply, the proposed measures fail to recognize that income trusts have provided a much-needed alter-native source of capital – particularly in the infrastructure sector, which plays a critical role in the competitiveness of Canada's economy.

We are continuing to press for changes to the government's "solution," but regardless of what actions are finally taken, we are confident that the Fund will adapt to the new circumstances and continue to prosper. Our solid asset base, proven operational accomplishments and disciplined financial management have served us well for the last 10 years and set the foundation for future success.

In conclusion, we extend our sincere gratitude to all those who have contributed to the Fund's success in 2006 and over the past decade – investors, custom-ers, employees, trustees, suppliers and many others. We look forward to celebrating the Fund's 10th anniversary this year and to sharing with you continued success and prosperity in the years to come.



James C. Temerty
Chairman,
Northland Power Income Fund Management Inc.



John W. Brace
President and CEO,
Northland Power Income Fund Management Inc.

The following is a discussion of the consolidated financial condition and results of operations of Northland Power Income Fund (the "Fund"). It should be read in conjunction with the audited consolidated financial statements. Additional information relating to the Fund can be found in the Annual Information Form, which is filed electronically at www.sedar.com. The Fund's financial statements have been prepared in accordance with Canadian generally accepted accounting principles (GAAP). All dollar amounts in this management's discussion and analysis (MD&A) are in Canadian dollars unless otherwise stated.

This MD&A compares the Fund's 2006 financial results to the financial results for 2005. The 2006 consolidated financial statements include the results of the Fund and NPIF Commercial Trust (NPIF CT), the Iroquois Falls facility owned by Iroquois Falls Power Corp. (IFPC), the Kingston facility owned by Kingston CoGen Limited Partnership (KCLP), the Mont Miller facility owned by Mount Miller Wind Energy Limited Partnership ("Miller LP") and the German wind farms owned by DK Windpark Kavelstorf GmbH & Co. KG and DK Burgerwindpark Eckolstädt GmbH & Co. KG ("the German wind farms"). The Fund's investment in KCLP increased from 50% to 100% on March 23, 2006, when the remaining 50% interest was purchased from a subsidiary of the AES Corporation. Unitholders at a special meeting on January 30, 2007, approved the internal reorganization of the Fund's ownership of its Kingston facility such that it is now held through a flow-through entity for tax purposes. On April 25, 2006, the German wind farms were purchased with ownership effective April 1, 2006. The Fund's investment in Panda Energy Corporation (PEC) is accounted for under the cost method, whereby investments are carried at cost and are adjusted only for other-than-temporary declines in fair value, distributions of capital and additional investments. Interest earned from the senior loan to Panda Interfunding Company LLC (PIC), a wholly owned subsidiary of PEC, and dividends earned on the 19% equity interest in PEC are reported as investment income.

The Fund's trust units and convertible debentures, which trade on the Toronto Stock Exchange under the symbols NPI.UN and NPI.DB, respectively, are qualified investments for RRSPs and DPSPs under the Canadian Income Tax Act.

Fund Management

The Fund is administered and IFPC, Miller LP and KCLP are managed by Northland Power Income Fund Management Inc. (NPIFMI or "the Manager"), a wholly owned subsidiary of Northland Power Inc., which is a leading Canadian independent power company with extensive experience in all aspects of private power development and operational management. PEC and PIC are managed by Panda Global Services Inc., and the German wind farms are managed by enXco GmbH, with oversight provided by the Manager. Governance is provided by the five trustees of NPIF Commercial Trust (which is wholly owned by the Fund), who have primary responsibility for the oversight of the Fund and its investments, as well as providing direction to the Manager. Additional details on the relationship between the Manager and the Fund and amounts paid to the Manager and its affiliates during 2006 are outlined in note 19 to the audited consolidated financial statements of the Fund.

Forward-Looking Statements

The annual report, including this MD&A, contains forward-looking statements based on assumptions that were considered reasonable at the time it was prepared on February 15, 2007. These statements, by their nature, necessarily involve risks and uncertainties that could cause actual results to differ materially from those contemplated by the forward-looking statements. Some of the factors that could cause results or events to differ from current expectations include, but are not limited to, the factors described in the "Risks and Uncertainties" section.

Non-GAAP Measures

Included in this MD&A are references to the Fund's distributable cash and distributable cash per unit and funds from operations before working capital changes as methods of highlighting the Fund's results and operations. Readers should be aware that distributable cash and funds from operations before working capital changes are not measures under Canadian GAAP, and there is no standardized measure for them. Distributable cash and funds from operations before working capital changes as presented may not be comparable to similar measures presented by other income funds. Management believes that these measures are widely accepted financial indicators used by investors to assess the performance of an income trust and its ability to generate cash through operations. This is especially true of the Fund, which pays out the majority of its cash generated in regular distributions. For a reconciliation of the non-GAAP measures to the most directly comparable measures calculated in accordance with GAAP, see "Distributions to Unitholders and Distributable Cash."

Stability Ratings

To help investors understand and evaluate investment in an income fund, stability rating scales have been developed. According to Standard & Poor's (S&P), "the stability rating assesses both the volatility and sustainability of the cash distribution stream of the securities." On January 17, 2007, S&P confirmed the Fund's stability rating at SR-2 with a stable outlook, while lowering the Fund's distribution profile assessment to "moderate".

Strategy and Key Factors Supporting Sustainability

Fund Profile

Northland Power Income Fund indirectly owns interests in six power generating facilities: three combined-cycle cogeneration power plants that efficiently and cleanly produce electricity and steam for sale and three wind farms. Two cogeneration plants are located in Ontario: the 120 MW Iroquois Falls facility that has been wholly owned by the Fund since its inception in 1997 and the 110 MW Kingston facility, of which the Fund has owned 100% since March 23, 2006. Through its 19% equity interest in PEC and loan to PIC, the Fund has an interest in the 230 MW Panda-Brandywine cogeneration power plant located outside Washington, D.C. Electricity sales from the cogeneration plants are made under long-term power purchase agreements (PPAs) with creditworthy customers to ensure revenue stability, and long-term contracts assure the supply and price of natural gas, which is the Fund's largest cost. The 54 MW Mont Miller wind farm near Murdochville, Quebec, began commercial operations in June 2005 and sells electricity under a long-term PPA to Hydro-Québec. In April 2006, the Fund acquired two German wind farms with 21.5 MW of installed capacity. These farms have been operational for more than five years with all electricity generated being supplied to regional power utilities under the terms of German renewable energy legislation.

With commercial operation of the Mont Miller wind power project in 2005 and the acquisition of the German wind farms in 2006, the Fund's cash flows are diversified over four geographically separate regions and regulatory regimes. Also, as the Mont Miller and German wind farms use turbine technology powered by wind, the risk associated with the Fund's dependence on turbine technology powered by fossil fuels has been reduced.

Investment Objective and Strategy

The Fund's investment objective is to produce stable and sustainable levels of cash for distribution to Unitholders from assets, businesses and investments related to the production, conversion, transmission, distribution, purchase and sale of electricity and other forms of energy, energy-related projects and fuels.

To achieve its investment objective, the Fund focuses on minimizing costs, utilizes assets efficiently, maintains a strong balance sheet and intends to continue to build on the Fund's existing base of high-quality contracted power facilities in order to increase and diversify its cash flow stream and the long-term value of its portfolio.

Long-Term Contracts

An essential element of the Fund's business strategy to assure the predictability of distributions is to have the majority of the Fund's revenue and costs determined under long-term contracts with creditworthy counterparties. The major terms of the long-term PPAs and fuel-supply contracts are aligned for each project such that revenue and cost escalation are linked, providing assurance of long-term profitability for the project. The following table highlights the counterparties, their credit ratings and the term of the revenue and fuel-supply contracts for each of the Fund's investments.

Project	Capacity	Ownership	Power off-taker & rating*	PPA term	Fuel-supply term
Iroquois Falls	120 MW	100%	OEFC† (AA)	2021	2015–16
Kingston CoGen	110 MW	100%(1)	OEFC (AA)	2017	2017
Panda-Brandywine(2)	230 MW	Loan + 19% (49% option in 2021)	PEPCO†† (BBB+)	2021	2011(3)
Mont Miller	54 MW	95%	Hydro-Québec (A+)	2026	N/A
Germany(4)	21.5 MW	100%	N/A(5)	2021–22	N/A

* Ratings by Standard & Poor's

† Ontario Electricity Financial Corporation

†† Potomac Electric Power Company

(1) The Fund increased its equity interest in the Kingston facility from 50% to 100% on March 23, 2006.

(2) A subsidiary of the Fund is the lender under a senior unsecured loan to a subsidiary of Panda Energy Corporation, which indirectly owns the Panda-Brandywine facility.

(3) As a result of the Panda-Brandywine facility's PPA pricing for energy payments being tied to monthly market price indices for natural gas after October 2011, energy revenues for the facility are expected to maintain a close correlation with market-based fuel costs after the firm gas supply agreement expires.

(4) The German wind farms were acquired effective April 1, 2006.

(5) German electricity production is purchased by local power utilities as required by German legislation at predetermined prices.

Maintenance of Productive Capacity

The Fund invests in durable assets and ensures that its investments have a long physical life and predictable operational costs. The gas turbines at the Iroquois Falls and Kingston projects are maintained under long-term contracts with General Electric Canada (GE), the original equipment supplier, that include provision for routine maintenance and repairs, as well as upgrades and improvements that return the equipment to essentially as-new condition periodically. A cash maintenance reserve for the Kingston facility helps level year-to-year variations in gas turbine overhaul costs. The wind turbines at Mont Miller and the German wind farms are maintained by the original suppliers under contracts. The Fund's annual operating and maintenance expenses largely provide for the upkeep of its equipment with the result that capital costs associated with equipment maintenance are low. Reserves are provided for infrequent but predictable major maintenance costs on long-lived assets such as steam turbines and boilers.

Post-Contract Economics

When the Fund's revenue and cost contracts come to an end, depending on market conditions and particularly whether or not the expiring contracts are above or below then-prevailing market prices, the Fund may be able to extend maturing contracts or enter into new ones. In any case, the Fund may be able to operate its facilities without contracts, perhaps under a different operating mode (e.g., gas-fired plants may operate only during periods of peak prices, which may entail a capital investment for plant modifications at that time), in which case facility profitability may be unfavourable as compared to economics under the expiring contracts.

To help mitigate the possibility of less favourable economics at the expiry of existing contracts, the Fund has partially financed a portion of some projects (Mont Miller and Kingston) with long-term debt that is amortized (i.e., fully repaid) over the term of the original PPA. As a result, with no debt payments to be made beyond the term of the PPA, individual projects may remain economically viable even with lower revenues.

The Fund's policy is to maintain a conservative payout ratio in order to allow for year-to-year variability in distributable cash, as well as to provide funds for long-term expansionary capital expenditures and investments.

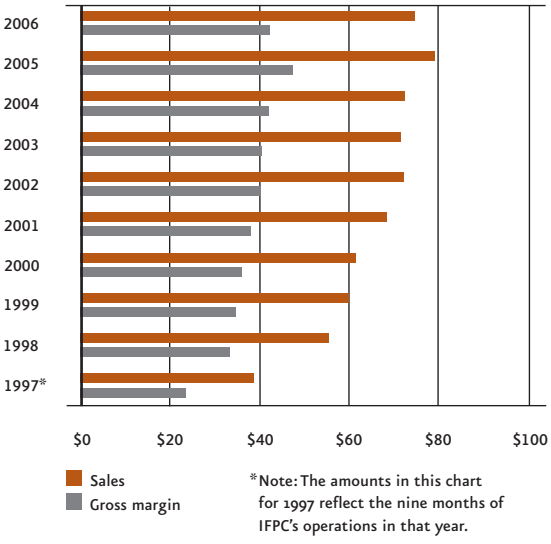
In evaluating all acquisitions since the initial public offering in 1997, the Fund's management has made explicit assumptions about the value of all its new investments after the expiry of the original PPA, adjusting the acquisition price accordingly. This discipline, when combined with the conservative payout policy, is designed to ensure that the Fund can sustain distributions to Unitholders for the foreseeable future.

Iroquois Falls Facility

The 120 MW Iroquois Falls facility has been wholly owned by the Fund since its inception in 1997. The Iroquois Falls facility generates electricity and sells it to Ontario Electricity Financial Corporation (OEFC) under a PPA expiring in 2021. The PPA obligates OEFC to purchase certain quantities of electricity ranging from a monthly average of 77 MW in the summer months to 96 MW in the winter (the yearly average is approximately 85 MW).

Steam is supplied by the Iroquois Falls facility to the neighbouring Abitibi-Consolidated Company of Canada ("Abitibi") pulp and paper mill under a steam sales agreement that expires in 2016.

IFPC sales and gross margin In millions



The Iroquois Falls facility is fuelled by natural gas provided by EnCana Corporation and Shell Canada Ltd. pursuant to gas supply contracts that end in 2015 and 2016. The gas is transported through pipelines owned by TransCanada PipeLines Limited and Union Gas Limited from Western Canada to the plant site under firm service agreements that run to 2016.

Previously, additional volumes of natural gas were supplied to the Iroquois Falls facility by Calpine Canada Natural Gas Partnership ("Calpine"). However, on December 20, 2005, Calpine Corporation, the indirect parent company of Calpine, filed for bankruptcy protection in the United States, and subsequently it was announced that Calpine was a party to insolvency proceedings in Canada. Calpine ceased supplying natural gas to IFPC's Iroquois Falls facility in January 2006. The Calpine supply was subject to a backstop arrangement under another of IFPC's gas supply contracts that provides for replacement of a significant portion of the Calpine volume in the event of a supply default. On May 10, 2006, delivery of additional quantities of natural gas began under the backstop agreement. At the same time, the supplier also agreed to withdraw an unrelated claim for approximately $7.6 million plus interest that was filed in 2004. As part of the final agreement, both parties agreed to certain changes to the contractual backstop provisions.

The maintenance of the two General Electric LM 6000 PD gas turbines is contracted to GE under a maintenance agreement that, based upon the expected usage of the turbines, will continue until 2015. The agreement with GE includes provisions for routine maintenance and repairs, as well as upgrades and improvements. Payments to GE are based on the usage of the gas turbines. The Iroquois Falls facility also participates in the GE gas turbine lease pool that guarantees the availability of replacement gas turbines on short notice, which minimizes the risk of extended outages.

The unionized employees at the Iroquois Falls facility work under a collective agreement that expires June 30, 2010.

The Iroquois Falls facility is operated by NPIFMI under a management agreement that expires in 2021.

Iroquois Falls Facility

In thousands of dollars except as indicated	**2006**	2005	2004
Volumes			
Electricity (MWh)	**636,795**	698,068	693,851
Steam (000 lb.)	**1,070,538**	1,007,576	993,951
Fuel consumption (000 GJ)	**6,225**	6,596	6,574
Sales			
Electricity – contracted	**61,460**	61,789	58,741
Electricity – non-contracted	**568**	2,786	1,177
Steam	**6,593**	6,141	5,906
Natural gas	**5,880**	7,626	6,250
Emission allowances and credits	**210**	924	450
	74,711	79,266	72,524
Cost of sales			
Gas consumed	**26,676**	26,680	26,039
Gas resold	**5,817**	5,060	4,368
	32,493	31,740	30,407
Gross profit	**42,218**	47,526	42,117
Plant operating costs	**6,905**	6,356	6,362
Capital expenditures	**91**	107	74

Electricity production at the Iroquois Falls facility declined in 2006 for several reasons. First, production was "backed down" (i.e., reduced) during lower-priced off-peak periods (nights, weekends and statutory holidays) due to lower availability of contracted natural gas as a result of the supply default in January 2006 by Calpine that was only partially offset by additional gas received from another supplier under an amended backstop arrangement. Second, there were minimal sales outside the terms of the PPA as a result of low wholesale

market prices compared to the prior year. Third, electricity production was adversely affected by a longer-than-normal summer shutdown during the third quarter of 2006 for a scheduled inspection and overhaul of the steam turbine.

Sales in 2006 at $74.7 million were down $4.6 million (6%) from the prior year, primarily due to lower electricity production and natural gas sales.

Total electricity production was down by 61,000 MWh (9%) from the 2005 volume due largely to the reasons cited previously. However, electricity sales revenue under the Iroquois Falls PPA was only $0.3 million off last year due to an increase in the rates under the PPA and a $0.2 million retroactive payment received from OEFC in 2006 related to sales made in 2005.

Changes in rates under the Iroquois Falls PPA are based primarily on a three-year rolling average of changes in the Wholesale Customer Rate, calculated semi-annually, subject to a floor and ceiling mechanism. This rate represents the delivered cost of electricity to large industrial power consumers in Ontario. The 2006 increase was determined by adding the 2006 delivered cost of electricity in Ontario to the calculation and removing the 2003 cost. As a result, most of the PPA rate components increased by 3% in 2006 largely due to higher electricity market prices experienced during 2005, the result of extreme summer weather conditions.

Low wholesale market electricity prices and gas supply constraints in 2006 limited sales of electricity outside the terms of the PPA compared to 2005.

Steam revenue was 7% higher in 2006 largely because Abitibi required more steam. Natural gas was bought and resold during the year to mitigate unused capacity under the plant's TransCanada PipeLine contract as a result of the reduction in contracted gas supply. Sales of emission allowances and credits (300 tonnes) generated revenue of $0.2 million this year, $0.7 million lower than in 2005. Emission allowances and credits are being held in inventory due to unattractive, low market prices.

The cost of sales was $0.8 million higher than the previous year due to an increase in the cost of gas resold, while lower electricity production resulted in a 6% reduction in the volume of gas consumed. At $26.7 million, the cost of natural gas consumed in 2006 was in line with the prior year despite lower scheduled electricity production and transportation tariffs, due to a 15% price increase resulting from the scheduled "reopening" of the price under one gas supply contract that represents approximately 60% of the facility's gas consumption. The cost of natural gas resales was higher than last year because purchases, primarily at market prices (rather than lower, contracted prices, as in past years), were made to mitigate fixed transportation costs.

The Manager is responsible for managing the Iroquois Falls facility's gas supply and resale and bears the indirect expenses of its participation in the wholesale electricity market. During 2006, the Manager earned $0.7 million in electricity and natural gas incentive management fees, compared to $2.2 million in 2005, largely due to constrained electricity sales and lower margins earned on the resale of natural gas. Electricity and natural gas management incentive fees earned by the Manager are included in cost of sales.

Gross profit of $42.2 million was down $5.3 million mainly due to lower earnings from both electricity sales and natural gas resale margins. Plant operating costs were up $0.5 million as a result of the scheduled inspection and overhaul of the Iroquois Falls steam turbine. Such inspections are required at periodic intervals; this was the first since the facility's startup in 1996. The expense for the inspection and overhaul was financed from funds that had been previously set aside for major maintenance.

The rates for electricity sales under the PPA in 2007 will continue to be favourably affected by the high Wholesale Customer Rate in 2005 through the three-year rolling average mechanism as previously described.

As a result of the settlement with one of Iroquois Falls' gas suppliers in May 2006 with respect to the backstop agreement, the Iroquois Falls facility will have access for the full year in 2007 (compared to eight months in 2006) to the back-stop volume, providing additional quantities of contract natural gas for resale and consumption in 2007.

In 2006, the cost of natural gas was affected by the scheduled "reopening" of the price under one gas contact that represents approximately 60% of the Iroquois Falls facility's gas consumption. The contract that supplies the remaining 40% of Iroquois Falls facility's gas consumption "reopens" in 2008 and is subject to a maximum price increase of 15%.

Major maintenance is not planned for 2007; the next scheduled major maintenance is planned for 2010, when the gas turbines will be overhauled, a cost that is largely covered by the GE maintenance agreement.

As at December 31, 2006, the Iroquois Falls facility had no forward sales commitments of excess contracted natural gas (2005 – nil).

Kingston Facility

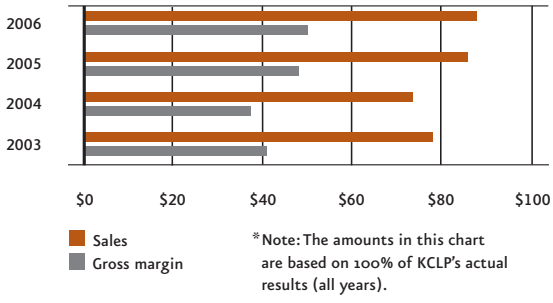
The Fund acquired a 25% interest in KCLP on December 31, 2002, and an additional 25% on December 15, 2004. The remaining 50% interest in KCLP was acquired on March 23, 2006, for $127.9 million plus $0.5 million in transaction costs. The Fund issued 11,560,000 subscription receipts at $15.15 each for net proceeds of $165.8 million primarily to fund this acquisition. As part of the transaction, the Manager earned a one-time fee of $2.0 million, which is included in the Fund's consolidated statement of income and deficit, and will henceforth earn an incremental management fee of $0.3 million per annum.

Subsequent to the acquisition of the remaining 50% of KCLP, the $33.5 million that KCLP owed OEFC through its levelization account was repaid.

KCLP has a long-term PPA with OEFC for the sale and delivery of a specified quantity of electricity through to 2017. The agreement can be extended for a further five years with the consent of both parties at rates agreed upon at that time.

KCLP provides steam to an adjacent facility owned by INVISTA (Canada) Company ("INVISTA") under an energy services agreement that expires in 2017. KCLP also has long-term contracts with INVISTA until 2018 for the supply of water from Lake Ontario through their pumphouse and for the treatment and disposal of process wastewater and sanitary wastewater.

KCLP sales and gross margin* In millions



*Note: The amounts in this chart are based on 100% of KCLP's actual results (all years).

KCLP has a gas purchase agreement with EnCana Corporation for the supply of natural gas through to 2017. TransCanada PipeLines Limited and Union Gas Limited transport the gas under separate long-term firm transportation agreements.

EnCana Corporation is responsible for the management of all aspects of the gas supply under a fuel management agreement with KCLP, which incorporates a separate formula for sharing profits on reselling of excess contract natural gas. This agreement expires in 2017.

The maintenance of KCLP's GE 6FA gas turbine is contracted to GE under a maintenance agreement that, based upon the expected usage of the turbine, will continue until 2016. Payments to GE are based on the usage of the gas turbine, scheduled milestones and a monthly fee.

After acquiring the remaining 50% interest in KCLP on March 23, 2006, operation of the Kingston facility became the responsibility of NPIFMI, pursuant to a management agreement expiring in 2017.

In accordance with the terms of the KCLP Credit Agreement, KCLP maintains a major maintenance reserve to cover the costs resulting from regular planned gas turbine maintenance inspections and overhauls. The major maintenance reserve is funded and retained in a separate interest-bearing account.

Kingston Facility

In thousands of dollars except as indicated	**2006 (100%)**[1]	2005 (50%)	2004 (25%)[2]
Volumes			
Electricity (MWh)	**449,019**	248,259	113,961
Steam (000 lb.)	**247,003**	145,834	72,957
Fuel consumption (000 GJ)	**4,220**	2,344	1,077
Sales			
Electricity – contracted	**56,590**	31,740	13,927
Electricity – non-contracted	**–**	–	–
Steam	**2,641**	1,139	453
Natural gas	**18,742**	10,277	4,035
Emission allowances and credits	**–**	182	–
	77,973	43,338	18,415
Cost of sales			
Gas consumed	**25,380**	14,800	7,081
Gas resold	**8,197**	4,500	1,982
	33,577	19,300	9,063
Gross profit	**44,396**	24,038	9,352
Plant operating costs	**5,321**	3,454	2,430
Capital expenditures	**61**	1,398	1,504

(1) 2006 results include 50% of the Kingston facility's operations up to March 22 and 100% for the remainder of the year and also include the impact of the repayment of the KCLP levelization account and reduction in management fees.

(2) 2004 results include the Fund's original 25% investment in KCLP up to December 15, 2004, and 50% thereafter.

The comments below relate to the operations of the Kingston facility in total, without reference to the Fund's increased ownership interest.

Electricity sales at the Kingston facility were up slightly in 2006 due mostly to an increase in the sales volume. There was no maintenance outage for the gas turbine in 2006 compared to a short maintenance outage in 2005. The contracted average selling price of electricity was relatively flat between 2005 and 2006. Under the KCLP PPA, more than half of the overall contract price for electricity is linked to underlying fixed and variable fuel tariffs.

Steam volumes were down 1% from 2005. A 37% increase in the average selling price of steam was the main driver for the overall 36% increase in steam revenue. The contract price for steam is tied to Union Gas tariff rates and is reset at the beginning of each year. Revenue from the resale of natural gas was relatively consistent with the prior year with a 2% increase, the result of a 5% increase in the average selling price, partially offset by a 3% decrease in volume. Emission allowances were inventoried in 2006 rather than being sold at unattractive, low market prices.

The cost of natural gas consumed was consistent with the prior year as the slight increase in electricity production was offset by lower overall fuel tariffs. The cost of gas resold was also consistent with 2005. Plant operating costs were down 11% mostly as a result of lower insurance premiums and lower maintenance costs (there were no maintenance outages in 2006).

In 2007, there is a modified combustion inspection maintenance outage that is scheduled for the long weekend in April. It will be a six-day outage, which includes three on-peak days.

As at December 31, 2006, forward sales commitments of excess gas for resale totalled $22.6 million (2,613,000 gigajoules (GJ)), compared to $42.8 million (5,140,000 GJ) in 2005.

KCLP signed a term sheet with OEFC near the end of 2006 that will allow KCLP to participate in market opportunities (incremental production, operating reserves, etc.) and share the profits with OEFC. The cash flow impact is expected to be positive for KCLP in 2007, albeit fairly small.

Mont Miller Wind Farm

The Mont Miller facility is a 54 MW wind farm located near the town of Murdochville, Quebec, in the Gaspésie region, approximately 80 kilometres west of Gaspé and 35 kilometres south of the St. Lawrence River. Construction of the facility began in August 2004, and commercial operations commenced on June 9, 2005.

The Mont Miller facility generates power from 30 Vestas V80 wind turbines, each with a capacity of 1.8 MW. The Mont Miller facility is located on Crown land that is leased for 25 years from the Government of Quebec and is renewable for an additional 15 years.

All power produced by the Mont Miller facility is contracted to be sold to Hydro-Québec under a 21-year PPA. The price of the power is $56.49 in 2006 per MWh and escalates at 1.5% per annum for the term of the agreement. There is no minimum or maximum production or delivery requirement. Miller LP also receives a payment under the federal government's Wind Power Production Incentive program. The incentive lasts until June 2015 and provides $10 per MWh, which is shared equally between Miller LP and Hydro-Québec.

Miller LP has also entered into a five-year warranty, maintenance and service agreement with Vestas-Canadian Wind Technology, Inc. ("Vestas"). Under the terms of this agreement, Vestas provides all scheduled and unscheduled maintenance required for the wind turbines, including all labour, repairs, replacement parts and supplies. The agreement also provides specific guarantees for maintenance-related availability (95%) and power output (95% of the turbines' rated capacity). The Manager of the Fund manages operations of the Mont Miller facility.

Upon completion of the construction of the Mont Miller facility, the developer of the project, Mount Miller Construction and Services Inc. (a 50%-owned subsidiary of the parent of the Manager) was entitled to a one-time special distribution on the Class "B" subordinated units of Miller LP equal to the amount that the actual costs of construction were less than the Fund's committed investment in the project. Accordingly, Mount Miller Construction and Services Inc. received a special distribution in the amount of $5 million during 2005. This special distribution was included in the capital cost of the project.

Mont Miller Wind Farm

In thousands of dollars except as indicated	**2006**	2005[1]	2004
Volumes			
Electricity (MWh)	**147,160**	91,361	–
Sales			
Electricity	**9,050**	5,574	–
	9,050	5,574	–
Gross profit	**9,050**	5,574	–
Plant operating costs	**1,933**	1,096	–
Capital expenditures	**–**	24,396	65,589

(1) From June 9, 2005, to December 31, 2005.

In 2006, the Mont Miller facility achieved turbine availability of 97% and a capacity factor of 31%. Capacity factor is an industry standard measure of a wind farm's performance over a given period and is defined as the ratio of actual production to hypothetical maximum production (i.e., the wind farm operates at its rated capacity all the time). Typical wind power capacity factors are in the range of 20–40%, depending on wind resource and turbine technology.

The turbines performed well during the year, and Mont Miller met its long-term expected availability.

Energy production fell short of expectations during 2006 by 25% as the wind resource was approximately 17% lower than the long-term projections because of the unusually calm winter of 2005–06, hot summer and warm fall. Nonetheless, wind speeds were within the range of variability predicted, and output of the facility is expected to meet projections under normal weather conditions. In addition, TransÉnergie, the transmission subsidiary of Hydro-Québec, restricted the project to 50% load for 35 days mainly during July and September to complete transmission line upgrades and maintenance work. These unusual events have a small possibility of recurring until local grid upgrades, expected to begin in the summer of 2007, are completed by TransÉnergie.

Under the terms of the Miller LP partnership agreement, the Fund is entitled to a priority annual distribution of $5.8 million, with any shortfall in the priority distribution carried forward to succeeding years. In addition, two-thirds of the fee due to the Manager for managing the facility is subordinated to receipt of the priority payment by the Fund. Once all priority distributions and subordinated management fees are paid on a cumulative basis, any excess cash generated will be split 50% to the Fund and 50% to Mount Miller Construction and Services Inc.

In 2007, the Manager expects the Mont Miller facility to achieve turbine availability of 97% and energy capture of 195.9 GWh, as forecasted by the long-term wind speed and energy assessment prepared by Garrad Hassan and Partners Ltd., a leading independent engineering consulting firm.

The cumulative shortfall in priority distributions was $2.5 million at December 31, 2006, which must be made up before Mount Miller Construction and Services Inc., as the holder of the Subordinated "B" units of Miller LP, receives any distributions.

The wind resource and energy production to date in 2007 have exceeded 2006 results and the long-term energy assessment.

German Wind Farms

In April 2006 the Fund acquired two operating wind farms in Germany with a total installed capacity of 21.5 MW. The acquisition was completed on April 25, 2006, with ownership effective April 1, 2006. The transaction involved the purchase of the entities that own the wind farms and related receivables for approximately $3.9 million and a loan from the Fund to retire $19.0 million of third-party debt, for an aggregate investment by the Fund of approximately $23 million. As part of the transaction, the Manager earned a one-time fee of $0.3 million, which is included in the Fund's consolidated statement of income and deficit and will earn an annual management fee of €75,000.

The 7.2 MW Kavelstorf wind farm comprises four Nordex N60 1.3 MW turbines and two Nordex N54 1.0 MW turbines. The Kavelstorf wind farm is located in northern Germany near Rostock and has been operational for five years. The 14.3 MW Eckolstädt wind farm includes 11 Bonus Energy A/S (a member of the Siemens AG group) turbines rated at 1.3 MW each. The Eckolstädt wind farm is located near Jena in central Germany and has been operational for approximately six years.

All electricity generated by the German wind farms is supplied to regional power utilities under the terms of German renewable energy legislation. Contracts are in place with affiliates of the turbine manufacturers to provide maintenance services. Management of daily operations of the wind farms is provided by enXco GmbH, a German entity with considerable wind power experience; oversight is provided by the Manager of the Fund.

German Wind Farms

In thousands of dollars except as indicated	**2006**[1]	2005	2004
Volumes			
Electricity (MWh)	**23,267**	–	–
Sales			
Electricity	**3,057**	–	–
	3,057	–	–
Gross profit	**3,057**	–	–
Plant operating costs	**761**	–	–
Capital expenditures	**–**	–	–

(1) From April 1, 2006, to December 31, 2006.

The wind resource and energy production surpassed long-term projections during the year, and the wind farms achieved a combined capacity factor of 16%. The turbines generally performed well, although annual wind farm availability of 94% was slightly below expectations following an interconnection socket failure at Eckolstädt in October. There were no other major maintenance issues during the year. Long-term turbine availability is expected to exceed 97%.

The capacity factors for the German wind farms are expected to be lower than Mont Miller as Germany generally has a lower wind regime (i.e., is less windy) than the Gaspésie region of Quebec. For this reason, legislated rates for wind power in Germany are generally significantly higher than rates available in North America.

In 2007 and thereafter, output at the German wind farms is expected to average 36,900 MWh and availability of 97%, consistent with the energy production assessment completed by Garrad Hassan and Partners Ltd.

The Fund has entered into foreign exchange contracts with respect to the Fund's net investment in the German wind farms. As at December 31, 2006, the Fund had the following foreign exchange forward contracts in place to fix exchange rates for the following amounts:

- **Forward contracts to sell €1 million semi-annually from April 2007 to April 2011 at $1.4334:€1; and**
- **A forward contract to sell €10 million April 2011 at $1.4536:€1.**

Of these contracts, $23.3 million was designated as a hedge of the net investment for accounting purposes, while the remaining $5.9 million was not designated as part of a hedging relationship for accounting purposes.

The wind resource and energy production have significantly exceeded expectations so far in 2007.

Panda-Brandywine Facility

In December 2003, when IFPC acquired a 19% equity interest in PEC and extended a senior loan of US$93 million, PEC, through its wholly owned subsidiaries, owned two combined-cycle cogeneration power facilities that use natural gas as their primary fuel: the 230 MW Panda-Brandywine facility, located just outside Washington, D.C., and the 180 MW Panda-Rosemary facility, located in Roanoke Rapids, North Carolina. The Panda-Rosemary facility was sold on February 8, 2005, under the terms of an agreement that was executed in November 2004; and Panda-Rosemary LP was wound up shortly thereafter. At the closing of the sale on February 8, 2005, the Fund received US$18.9 million (CA$23.5 million) as partial repayment of the senior loan, and payment of fees and dividends totalling US$4.8 million (CA$6.0 million). The interest rate on the balance of the Fund's senior loan was increased by 0.4% to 10.9% for the remainder of the term.

The 230 MW Panda-Brandywine facility is located in Maryland, just outside Washington, D.C., and started operations in October 1996. The facility produces electricity and steam using natural gas as the primary fuel and no. 2 fuel oil as a backup fuel. The facility has two GE industrial gas turbines with heat-recovery steam generators and a steam turbine. It supplies steam to an adjacent distilled water plant, also owned indirectly by PEC.

The Panda-Brandywine facility sells electrical capacity and energy pursuant to a PPA with Potomac Electric Power Company. Under the PPA, which remains in force until October 2021, a monthly payment is made for capacity and the facility must be dispatched (i.e., requested to operate) at 99 MW for no less than 60 hours per week. The Panda-Brandywine facility is certified as a qualifying facility (QF) under U.S. federal energy legislation. The PPA provides for fixed "capacity" payments that are not affected by the amount of electricity actually produced by the facility. "Energy" payments under the PPA are designed to offset the fuel and variable costs when the Panda-Brandywine facility is dispatched. The fuel supply is contracted under terms that integrate with the provisions of the PPA. Management of daily operations of the Panda-Brandywine facility is provided by Panda Global Services Inc.

The Fund's 19% equity interest (of which 9.5% is voting) and an option to increase that equity participation to 49% in 2021 upon a further payment provide the Fund with the opportunity to participate in increased revenues from the Panda-Brandywine facility.

The senior loan receivable is scheduled to be fully repaid through quarterly payments of principal and interest by November 2021. It is structured to provide principal and interest payments to the Fund in priority to any dividend payments. Interest on the loan has not been and is not expected to be subject to U.S. withholding tax, while dividends received by the Fund are subject to U.S. withholding tax.

The Fund has entered into U.S. dollar forward contracts to mitigate adverse changes in the U.S. dollar exchange rate that hedged U.S. dollar payments received in 2004 through to November 2009.

Panda Energy Corporation

In thousands of dollars	**2006**	2005	2004
Dividends	**1,024**	2,646	860
Interest income	**10,099**	12,401	13,011
Total investment income	**11,123**	15,047	13,871

Financial and operating results for the Panda-Brandywine plant were lower than those of 2005 when unseasonably hot weather resulted in higher dispatch levels at the facility to meet the increased electricity demands. According to the manager of the Panda-Brandywine plant, 2006 production of 497,000 MWh was 79,000 MWh lower than 2005. Commensurate with decreased production, sales and net income were 14% and 5% lower than last year, respectively.

Investment income of $11.1 million declined from last year by $3.9 million as 2005 was affected by the one-time impact of the sale of the Panda-Rosemary facility and subsequent principal prepayment on the senior loan in February 2005. As a result of a lower principal balance after the prepayment, interest income was lower in the later half of 2005 and all of 2006. Investment income in 2005 included the one-time equity distribution of US$1.4 million and the receipt of a prepayment premium in the amount of US$1.1 million, both related to the Panda-Rosemary sale transaction.

The Panda-Brandywine facility does not have any major maintenance scheduled for 2007. The last scheduled major maintenance was performed in 2005.

As at December 31, 2006, the Fund had foreign exchange contracts outstanding to sell US$900,000 in February 2007 at CA$1.22 in respect of the next interest and principal payment to be received on the senior loan receivable, and US$750,000 per quarter to November 2009 at CA$1.1361. The change in fair value of these contracts at December 31, 2006, was not significant.

As a result of the strengthening of the Canadian dollar since the inception of the senior loan and the original foreign exchange contracts expiring, investment income from the senior loan is expected to be lower starting in 2007.

Northland Power Income Fund Consolidated Results

The financial results for 2006 include the financial contribution of 100% of the Kingston facility from March 23, 2006, including the impact of the subsequent repayment of the levelization account and reduction in management fees (compared to 50% in 2005); operation of the Mont Miller wind farm for the whole year (compared to the 206 days from June 9 to December 31 in 2005); and results from the German wind farms effective from April 1, 2006. The one-time impact of the sale of the Panda-Rosemary project in the first quarter of 2005 is included in the results for 2005. Differences in financial results between 2006 and 2005 are largely accounted for by these events.

In thousands of dollars except as indicated	**2006**	2005	2004
Volumes			
Electricity (MWh)	**1,256,241**	1,037,688	807,812
Steam (000 lb.)	**1,317,541**	1,153,410	1,066,908
Fuel consumption (000 GJ)	**10,445**	8,940	7,651
Sales	**164,791**	128,178	90,939
Cost of sales	**66,070**	51,040	39,470
Gross profit	**98,721**	77,138	51,469
Expenses			
Plant operating costs	**14,920**	10,906	8,792
Amortization of property, plant and equipment	**25,355**	17,097	11,661
Management and administration costs	**11,111**	4,863	3,745
Accretion expense	**174**	79	–
	51,560	32,945	24,198
Investment income	**11,123**	15,047	13,871
Income from operations	**58,284**	59,240	41,142
Foreign exchange	**(26)**	2,185	8,677
Amortization of deferred charges	**654**	1,284	321
Amortization of contracts	**11,532**	1,120	711
Interest income	**(840)**	(478)	(265)
Interest expense and bank fees	**13,700**	10,458	3,944
Income before income tax	**33,264**	44,671	27,754
Current income taxes	**(588)**	611	91
Future income taxes	**(297)**	(261)	525
	(885)	350	616
Net income	**34,149**	44,321	27,138
Net income per trust unit – basic	**$0.58**	$0.91	$0.57
Net income per trust unit – diluted	**$0.58**	$0.87	$0.55

Sales, cost of sales and plant operating costs were up compared to 2005 primarily due to the acquisitions and the reasons cited previously under each of the facilities' results. Plant operating costs and amortization of property, plant and equipment were up $12.3 million due largely to the acquisitions made by the Fund early in the year. Management and administration costs were $6.2 million higher, commensurate with higher legal and accounting costs, payment of a management incentive fee to the Manager and the one-time payments of $2.0 million and $0.3 million to the Manager related to the Kingston and German acquisitions. The Manager earned a management incentive fee of $1.8 million based on distributable cash in 2006 (2005 – nil), equal to 25% of the amount by which annual distributions to Unitholders exceed $0.934 per unit, less the amount of certain operational incentive fees that are included in cost of sales. This is the first time the Manager has earned this fee as the deduction in the calculation for operational incentive fees is down in 2006 compared to prior years due primarily to the Calpine contract gas supply issues at IFPC. The accretion expense relates solely to the asset retirement obligation at the Fund's wind farms.

Investment income declined from 2005, mainly due to the impact of the senior loan principal prepayment as discussed previously. The principal prepayment also resulted in higher amortization of deferred charges in 2005 compared to 2006 due to the recognition of deferred transaction costs when the prepayment occurred. Due to the U.S. dollar/Canadian dollar exchange rate at year-end approximating last year's closing rate, an insignificant, non-cash foreign exchange adjustment was required this year to the PIC senior loan, compared to a $1.6 million loss in 2005 when the Canadian dollar strengthened significantly throughout the year.

Contract amortization was up significantly from 2005 as a result of the Kingston and German acquisitions in early 2006 and the resulting amortization of the fair value increments on the contracts acquired. The net contract value of $142.7 million on the Fund's consolidated balance sheet relates to the fair value of the power purchase agreements, natural gas purchase agreements and steam sales agreements of the operating entities when they were acquired by the Fund. The fair value of these contracts is amortized on a straight-line basis over the remaining term of the contracts.

Interest expense increased by $3.2 million from last year and largely represents the inclusion of an additional 50% of the Kingston facility debt, after taking account of the repayment of the levelization account, and interest on the $5.0 million of borrowing on the Fund's acquisition line of credit to assist with the purchase of the German wind farms.

The factors described above, partially offset by income tax recoveries mainly at the Fund's Iroquois Falls subsidiary, resulted in net income for 2006 of $34.1 million being $10.2 million lower than last year.

Issuance of Securities

The Fund successfully raised additional capital through the sale of its securities on March 23, 2006. A summary of the securities issue follows:

In thousands of dollars	Expected[1]	Actual March 23 offering[2]
Proceeds, net of costs	166,077	165,825
Acquisition of KCLP	(126,676)	(127,948)
Retirement of debt owed to OEFC	(33,199)	(33,458)
Costs of transaction	(2,520)	(2,520)
Funds retained for general purposes	3,682	1,899

(1) Per the prospectus dated March 16, 2006.

(2) On March 23, 2006, the Fund issued 11,560,000 subscription receipts at $15.15 per subscription receipt to raise proceeds of $165.8 million, net of costs. On the same date, the subscription receipts were converted to units; the proceeds from the issue were used by the Fund primarily toward the acquisition of the remaining 50% interest in KCLP and the retirement of KCLP's outstanding levelization account loan balance with OEFC. Proceeds from the offering, net of underwriters' fees and costs, were approximately $0.3 million less than expected as a result of higher than predicted legal and accounting costs incurred by the Fund in association with the offering. The KCLP acquisition cost was approximately $1.3 million higher than expected due to final adjustments related to the net working capital acquired by the Fund.

Liquidity and Capital Resources

In thousands of dollars	2006	2005	2004
Cash and cash equivalents	**13,484**	14,482	18,617
Total assets	**730,558**	548,850	575,687
Total long-term liabilities	**170,206**	150,528	190,850

Since December 31, 2005, cash and cash equivalents at $13.4 million have decreased by $1.0 million due to a combination of $70.6 million generated by operations and $48.3 million provided by financing activities offset by $119.9 million of investing activities.

Cash provided by operating activities of $70.6 million was $14.9 million higher than 2005, while funds from operations before working capital changes (a non-GAAP financial measure) were up $5.8 million as the one-time impact of the sale of the Panda-Rosemary facility in the first quarter of 2005 was more than offset this year by the contributions from the additional investment in the Kingston facility, operations at Mont Miller for the full year and the German wind farms acquisition in 2006. The $1.4 million decrease in non-cash working capital balances related to operations is related to the timing of receipts for electricity sales to OEFC.

Cash used for investing activities was up $132.9 million compared to 2005. Major activities in 2006 related to investing that affected cash were:

- the $117.8 million net investment to acquire the remaining 50% of the Kingston facility on March 23; and
- the $3.9 million net investment in the German wind farms on April 25.

Investing activities in 2005 included the US$18.9 million prepayment of the PIC senior loan and the associated wind-up and restructuring fees resulting from the Panda-Rosemary sale, as well as the construction costs related to the completion of the Mont Miller wind farm.

Financing activities provided $48.3 million and included $165.8 million of net proceeds from a subscription receipt offering on March 23 and $5.0 million borrowed on the Fund's acquisition line of credit to finance the German wind farm investment. These activities were offset primarily by the retirement of $19.0 million of third-party debt associated with the German wind farms, repayment of the $33.5 million KCLP levelization account debt to OEFC and distributions to Unitholders of $63.9 million. In 2005, the proceeds from the senior loan prepayment resulting from the Panda-Rosemary sale and draws on the Mont Miller construction and term loan were used to repay a portion of the outstanding balance on the acquisition line of credit and to purchase Mont Miller property, plant and equipment, respectively. Distributions to Unitholders of $63.9 million were up from the previous year due to an increase in the rate of monthly distributions per unit, the issuance of 11,560,000 trust units on March 23, 2006, and the issuance of 1,342,080 trust units in exchange for $16.8 million of convertible unsecured subordinated debentures.

The Fund's assets have increased since December 31, 2005, as a result of the Fund acquiring the remaining 50% ownership interest in the Kingston facility in March and the investment in the German wind farms. The $19.7 million increase in long-term liabilities was mainly the result of acquiring the remaining 50% of the Kingston facility and its senior debt, partially offset by the repayment of the Kingston levelization account and the conversion of $16.8 million of convertible debentures into trust units during the year. Readers should refer to notes 8 and 11 in the audited consolidated financial statements for further details on the fair market value of assets and liabilities acquired during 2006.

Required maintenance-related capital expenditures for all of the Fund's existing facilities are expected to continue to be minimal in 2007.

Debt Covenants

The Fund conducts its business through separate legal entities (subsidiaries and affiliates) and is dependent on receipt of cash from those entities to defray its corporate expenses and to make distributions to Unitholders. Certain of those entities have outstanding debt that was incurred to help fund the entities' original investments. Under the credit agreements for such debt, it is conventional for distributions of cash to be prohibited if the loan is in default (notably for non-payment of principal or interest) or if the entity fails to achieve a benchmark debt service coverage ratio, which is the ratio of earnings before interest, taxes, depreciation and amortization (EBITDA, a non-GAAP measure) for a specified time period to the scheduled loan principal and interest payments for the same time period.

The Fund and its subsidiary, IFPC, have a line of credit totalling $95 million consisting of a $7.5 million revolving letter of credit facility used in meeting obligations under the Iroquois Falls TransCanada PipeLines Limited contract and an $87.5 million facility to assist in the funding of capital expenditures and investments, of which $10.0 million can be utilized as a revolving operating line of credit by IFPC for general corporate purposes. Amounts

drawn under the credit agreement are principally collateralized by general security and charge agreements that constitute a first priority lien on all of the real property and all of the present and future property and assets of IFPC and the Fund. As at December 31, 2006, a letter of credit for $7.5 million was outstanding and there was $5.0 million in borrowings under the acquisition line of credit. As long as there are advances to IFPC under the operating line or the Fund under the acquisition line, certain debt service coverage ratios must be met by IFPC and the Fund. If these covenants are not met, transfers from IFPC to the Fund and distributions to Unitholders may be restricted until the financial ratios are met. Under the Fund's credit agreement, each of IFPC and the Fund are required to have a debt service coverage ratio of at least 2.25 and a maximum debt to EBITDA ratio of 3.25, based on a historical rolling 12-month average. As at December 31, 2006, the Fund and IFPC achieved debt service coverage ratios of 4.30 and 217.00 and debt to EBITDA ratios of 1.60 and 0.00, respectively.

KCLP has in place long-term, non-recourse project financing in the amount of $93 million with a syndicate of banks. The interest rate has been fixed through interest-rate hedges on the outstanding loan balance. The bank financing is being fully amortized over the term of the Kingston PPA. Security under the credit agreement is limited to the assets of KCLP and an assignment of the Fund's ownership interest in KCLP. The credit agreement governing the term debt of KCLP requires that a debt service coverage ratio of at least 1.15 be achieved for the 12-month period preceding each semi-annual distribution date. Failure to achieve that benchmark requires the retention of any excess cash by KCLP until the next distribution date when the benchmark is achieved. Historically, KCLP has generally achieved a ratio in excess of 2.20. As at the latest calculation date, the ratio was 2.49.

KCLP's outstanding balance on its levelization account with OEFC of $33.5 million was repaid at the end of March 2006.

Miller LP has a $39 million term loan with The Manufacturers Life Insurance Company. The loan provided for interest-only payments until December 31, 2005, and quarterly payments of principal and interest thereafter until the loan is fully repaid at maturity on December 31, 2025, prior to the expiration of the PPA with Hydro-Québec. The credit agreement with The Manufacturers Life Insurance Company requires that a debt service coverage ratio of 1.20 be achieved for the 12-month period associated with each quarterly distribution, calculated on a historical and projected basis. If the ratio is between 1.20 and 1.50 then cash must be retained by Miller LP equal to a maximum of nine months of scheduled principal and interest payments in order to fund a debt service reserve account. Miller LP achieved a debt service coverage ratio of 2.00 for the 12 months ended December 31, 2006.

The payments by PIC on the Fund's senior loan and the payment of dividends by PEC are dependent on distributions by Panda-Brandywine LP, which owns the Panda-Brandywine project. Panda-Brandywine LP has obligations under a capital lease, including the requirement to achieve a 12-month debt service coverage ratio of at least 1.20 on a historical basis at the time it makes its quarterly distributions. The manager of Panda-Brandywine LP has advised the Fund that, historically, the ratio has averaged approximately 1.60 and has never been below 1.40. Panda-Brandywine LP achieved a debt service coverage ratio of 1.75 for the period ended January 31, 2007. Panda-Brandywine LP maintains a debt service reserve account balance equivalent to the next two scheduled quarterly capital lease payments.

Distributions to Unitholders and Distributable Cash

In thousands of dollars except as indicated otherwise	**2006**	2005	2004
Cash provided by operating activities	**70,567**	55,626	47,409
Net change in non-cash working capital balances related to operations	**1,399**	10,530	4,162
Funds from operations before working capital changes[1]	**71,966**	66,156	51,571
Capital expenditures	**(152)**	(25,901)	(67,166)
Add-back: expansionary capital expenditures	**–**	24,396	65,589
Receipts of principal on senior loan, excluding prepayment	**2,793**	1,512	941
Senior loan prepayment fees	**–**	1,890	–
Acquisition fees paid to Manager[2]	**2,385**	–	–
KCLP cash reserve drawdown (funding)	**(835)**	677	956
Scheduled debt repayments, net[3]	**(6,165)**	(2,614)	(961)
Future maintenance funds utilized (set aside)	**520**	(94)	(87)
Distributable cash[1]	**70,512**	66,022	50,843
Distributions declared to Unitholders	**64,937**	51,101	47,916
Average number of trust units – basic (thousands of units)	**59,311**	48,551	47,916
Per unit ($/unit)			
Funds from operations before working capital changes[1]	$1.21	$1.36	$1.08
Distributable cash[1]	$1.19	$1.36	$1.06
Distributions declared to Unitholders	$1.08	$1.05	$1.00

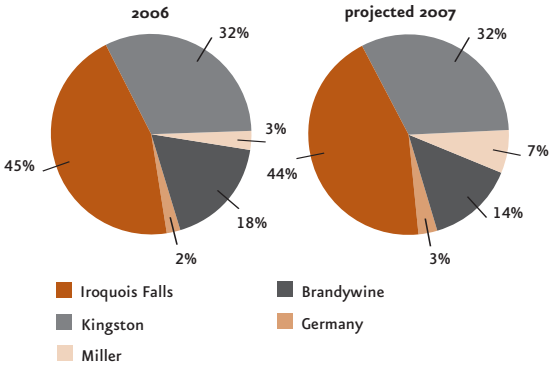
(1) Readers should refer to the disclosure statement regarding non-GAAP financial measures.

(2) Fees to the Manager in connection with the acquisition of 50% of KCLP on March 23, 2006, and the German wind farms on April 25, 2006.

(3) Excludes the $33.5 million lump-sum repayment of KCLP's levelization account with OEFC on March 31, 2006.

Funds from operations before working capital changes of $72.0 million exceeded the 2005 level by $5.8 million. The primary reasons for this variance were stated previously: the financial contribution of 100% of the Kingston project from March 23, 2006 (compared to 50% in 2005), taking account of the repayment of the levelization account and reduction in management fees on that date; operation of the Mont Miller wind farm for the whole year in 2006; and results from the German wind farms effective from April 1, 2006. The one-time impact of the sale of the Panda-Rosemary project was included in the results for 2005. The calculation of distributable cash includes the add-back of one-time fees related to acquisitions that were paid to the Fund's Manager that were included in operating activities for accounting purposes but are properly viewed as part of the Fund's investing activities. The calculation of distributable cash also includes deductions for scheduled repayments of debt principal as the Fund's Manager views the amount of cash that is available after scheduled debt repayments as the most appropriate indication of the amount that is available to be distributed to Unitholders. To help mitigate the possibility of less favourable economics at the expiry of existing contracts and therefore lower distributable cash, the Fund has partially financed a portion of some projects (Mont Miller and Kingston) with long-term debt that is amortized (i.e., fully repaid) over the term of the original PPA. As a result, with no debt payments to be made beyond the term of the PPA, the impact of the expiring PPAs on distributable cash will be partially mitigated.

Breakdown of distributable cash Per cent



The Fund invests in durable assets that have a long physical life and predictable operational costs. The gas turbines at the Iroquois Falls and Kingston projects are maintained under long-term contracts with GE, the original equipment supplier, that include provisions for routine maintenance and repairs, as well as upgrades and improvements that return the equipment to essentially as-new condition periodically. The wind turbines at Mont Miller and the German wind farms are also maintained by the original suppliers under contracts. The cost of these maintenance contracts are deducted from distributable cash through charges to income.

Distributable cash is also adjusted by maintenance reserves that provide for infrequent but predictable major maintenance costs on long-lived assets such as steam turbines and boilers.

Distributable cash of $70.5 million exceeded that of 2005 by $4.5 million (7%) and was $5.6 million higher than the distributions declared to Unitholders. During the year, the Fund's trustees approved an increase in the monthly rate of distributions to $0.09 per unit effective August 31, 2006, which is equivalent to $1.08 per unit on an annualized basis, a $0.03 per unit (3%) increase over 2005.

The Fund's distributions have been and are expected to be funded from the operations of the Fund's facilities and principal and interest payments on the Fund's senior loan receivable.

Management intends to maintain a prudent, sustainable level of distributions in relation to distributable cash, with excess cash being retained and held for reinvestment and future acquisitions.

Trust Unit and Convertible Unsecured Subordinated Debenture Information

As at December 31, 2006, the Fund had 62,333,383 trust units outstanding (December 31, 2005 – 49,431,303). A total of $16.8 million of convertible unsecured debentures were converted into 1,342,080 trust units, and the Fund issued an additional 11,560,000 trust units during 2006. As of the date of this MD&A, February 15, 2007, the Fund has issued and outstanding 62,334,183 units.

Quarterly Financial Information

In millions of dollars except per trust unit amounts	**2006**	**Q1**	**Q2**	**Q3**	**Q4**	**Total**
Sales		**35.8**	**40.6**	**40.5**	**47.9**	**164.8**
Net income		**12.1**	**3.5**	**5.8**	**12.7**	**34.1**
Net income per unit – basic		**0.239**	**0.056**	**0.093**	**0.205**	**0.576**
Net income per unit – diluted		**0.237**	**0.056**	**0.093**	**0.204**	**0.576**
Distributable cash per unit		**0.337**	**0.283**	**0.282**	**0.296**	**1.189**
Distributions declared per unit		**0.2625**	**0.2625**	**0.2675**	**0.2875**	**1.080**
	2005	Q1	Q2	Q3	Q4	Total
Sales		31.9	27.9	31.7	36.7	128.2
Net income		16.6	10.3	5.2	12.2	44.3
Net income per unit – basic		0.346	0.216	0.107	0.247	0.913
Net income per unit – diluted		0.313	0.195	0.107	0.243	0.867
Distributable cash per unit		0.447	0.259	0.285	0.369	1.360
Distributions declared per unit		0.2525	0.2550	0.2550	0.2875	1.050

Iroquois Falls' sales are seasonal, as OEFC has contracted for more electricity (and pays a higher price) in winter than in summer. In addition, steam sales to Abitibi tend to be higher in winter than summer. Financial results from the Fund's wind farms are expected to follow a similar seasonal pattern as Iroquois Falls, as it tends to be windier in the winter months compared to the summer months. Seasonality at the consolidated level has been dampened somewhat as the financial results for the Kingston facility are less seasonal than Iroquois Falls.

Net income also includes interest earned on the senior loan receivable from PIC, dividends received from the Fund's 19% equity interest in PEC (neither of which varies materially by season) and any non-cash foreign exchange adjustments required to translate the U.S.-dollar-denominated balance of the senior loan to the appropriate quarter-end Canadian dollar equivalent.

As a result of the factors stated above, the Fund's distributable cash per unit is normally highest in the first and fourth quarters and lowest during the second and third quarters.

Fourth Quarter 2006 Results

Sales of $47.9 million in the quarter increased by $11.3 million, while distributable cash of $18.4 million was higher by $0.2 million compared to the fourth quarter of 2005.

Electricity revenue under the Iroquois Falls PPA was up $0.3 million from the fourth quarter of the previous year primarily due to an increase in electricity production; 2005 production was affected by voluntary curtailment on weeknights to free up additional quantities of natural gas for resale at unusually high prices. Revenue earned from sales of electricity and operating reserves into the wholesale market was down slightly from the previous year as a result of low wholesale market prices. Steam sales were in line with 2005, while sales of natural gas to mitigate fixed transportation costs were down $1.6 million due to lower market prices and the reduction in contracted gas supply. The cost of sales was $0.2 million lower than last year as an increase in the cost of gas consumed, commensurate with higher production, was offset by a decrease in the cost of gas resold. Plant operating costs of $1.8 million were in line with 2005.

Electricity revenue at the Kingston facility increased from the same period last year as production in 2005 was voluntarily curtailed to facilitate the resale of additional quantities of natural gas. Steam revenue was up due to a higher average selling price, while revenue from the sale of natural gas was down due to lower market prices and increased electricity production, which left lower volumes of natural gas available for resale. Cost of sales was down largely due to lower fixed transportation tariffs. Plant operating costs were down due to a reduction in insurance premiums and maintenance costs compared to 2005.

In the fourth quarter of 2006, energy production at Mont Miller exceeded the prior year by 447 MWh or 1%. This was in spite of three failed gearboxes that have since been replaced at the manufacturer's expense and a four-day forced outage by Hydro-Québec for local transmission line modifications.

The German wind farms exceeded expectations for production during the fourth quarter of 2006 with an average capacity factor of 25%. The German wind farms' overall reliability of 91% in the quarter fell well below long-term expectations of 97% due to the failure of an interconnection socket at Eckolstädt in October; there were no other issues during the quarter as the turbines continue to perform well.

Management and administration costs were $2.6 million higher in the quarter largely due to a combination of additional expenses from the German wind farms and Kingston acquisitions in 2006, a management incentive fee to the Manager and legal fees incurred by the Fund for the special Unitholder meeting in January 2007 to approve the internal reorganization associated with the 2006 Kingston acquisition. At the time of the acquisition of the remaining 50% interest of KCLP in March 2006, the Manager planned to reorganize this investment into an existing partnership. An advance tax ruling was obtained from the Canada Revenue Agency for this reorganization, which also required Unitholder and KCLP's and the Fund's lenders' approval, which were obtained in January 2007. The 2006 management incentive fee in the amount of $1.8 million is equal to 25% of the amount by which annual distributions to Unitholders exceeded $0.934 per unit, less the amount of certain operational incentive fees that are included in cost of sales. The operational incentive fees

are earned by the Manager throughout the year as incremental electricity sales and natural gas resales are made, while the management incentive fee is not earned by the Manager until the fourth quarter when results for the year have been finalized.

The Fund's investment in PEC generated investment income of $2.5 million this quarter through a combination of interest and dividend payments, slightly lower than the same period last year.

During the fourth quarter, the Fund recorded a $3.4 million non-cash gain on the translation of the PEC senior loan balance to the quarter-end U.S. dollar/Canadian dollar exchange rate as a result of the Canadian dollar weakening during the quarter. Interest expense of $3.6 million was $0.5 million higher than last year due to including an additional 50% of the Kingston facility debt, after taking account of the repayment of the levelization account, and interest on the $5.0 million of borrowings on the Fund's acquisition line of credit to purchase the German wind farms. The acquisitions of the remaining 50% of the Kingston facility and the German wind farms in early 2006 also resulted in higher amortization charges related to the fair value increments of the contracts acquired.

The above factors, combined with the current income tax recovery and the provision for future taxes at the Fund's Iroquois Falls subsidiary, resulted in net income for the fourth quarter of 2006 being $0.6 million higher than the fourth quarter of last year.

Cash and cash equivalents decreased by $7.6 million during the quarter, mainly due to KCLP's scheduled debt repayment of $3.7 million and IFPC's repayment of $5.6 million on its bank indebtedness that arose in the third quarter of 2006 due to the timing of receipts on electricity sales to OEFC.

Participation in Thorold Cogeneration Project

Subject to a number of conditions and the completion of acceptable documentation, the Fund has agreed to provide $35 million of subordinated debt financing to Thorold CoGen LP, a wholly owned subsidiary of Northland Power Inc. Thorold CoGen LP is the owner of a 236 MW cogeneration facility to be constructed on the site of the Abitibi-Consolidated Company of Canada's newsprint mill in Thorold, Ontario, 70 kilometres southwest of Toronto near the U.S. border. Thorold CoGen LP was a successful bidder under the Ontario Power Authority's (OPA) combined heat and power request for proposals and entered into a 20-year power purchase agreement ("the CHP Contract") with the OPA on October 16, 2006.

The plant will be a natural-gas-fired cogeneration facility that will produce both electricity and steam from a 170 MW industrial gas turbine and associated 95 MW steam turbine. Electricity will be supplied to the OPA under the 20-year CHP Contract, which will provide revenue assurance and stability to the project, and steam and electricity will be sold to Abitibi under a 20-year energy supply agreement. The project will significantly reduce energy costs and improve the competitiveness of Abitibi's Thorold mill, which Abitibi considers one of its strategic assets. Construction of the approximately $450 million facility is sched-uled to begin in mid-2007, following the completion of all permitting and financing, and full commercial operations and supply of electricity are expected to commence late in 2009.

Financing for the Thorold cogeneration project, including the Fund's loan, is expected to close in the second quarter of 2007. Long-term non-recourse senior secured debt, equal to approximately 80% of total project costs, has been committed by Bank of Montreal, The Manufacturers Life Insurance Company and Sun Life Assurance Company of Canada.

The Fund's $35 million non-recourse subordinated loan will be repayable over five years commencing after the plant achieves commercial operation and will carry an interest rate of 12.5% from inception. The Manufacturers Life Insurance Company is providing $35 million to Thorold CoGen LP on identical terms. The Fund expects to finance the subordinated loan under its existing line of credit.

The contractual structure of the Thorold cogeneration project is designed to insulate Thorold CoGen LP from exposure to electricity price and dispatch risk, natural gas price volatility and delivery uncertainty, changes in steam demand, and performance-related issues. Northland Power Inc., the project's sponsor and equity provider, will bear the primary risk of any construction cost overruns. The Fund's Manager believes that the transaction is accretive and satisfies all the Fund's other acquisition criteria. The Fund has a right of first offer to acquire all or part of Northland Power Inc.'s interests in the project, should it decide to sell, at a price to be determined in the future. This arrangement allows the Fund to receive an attractive return by participating in the project from the beginning while remaining shielded from the construction and start-up risks and preserves the opportunity for a larger investment after the project is completed.

Tax Treatment of Distributions

Distributions to Unitholders in 2006 were 41.0% tax-deferred (2005 – 42.0%). The tax deferral arises as the Fund's capital cost allowance and expenses significantly reduce the Fund's income that would otherwise be taxable. The tax-deferred portion of distributions represents a return of capital for Canadian income tax purposes and reduces 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 trust unit are greater (or less) than the adjusted cost base of the unit and any associated selling expenses.

On October 31, 2006, the Canadian federal government announced tax proposals pertaining to taxation of distributions paid by income trusts and changes to the personal tax treatment of trust distributions that will be applicable starting in 2011. All investors saw the value of their units decline immediately after the announcement. While legislation was introduced on December 21, 2006, the government's proposals remain draft and have not passed into law. Readers should refer to "Risk and Uncertanties – Tax-Related Risks," for an explanation of the potential impact on Unitholders.

The tax-deferred portion of distributions is partly dependent on future capital cost allowance deductions on the remaining tax balances of the Fund and its subsidiaries' capital assets (undepreciated cost of capital or UCC). As at December 31, 2006, the UCC balances for the Fund and its subsidiaries are as follows:

In thousands of dollars

Rate of yearly write-off	4%	20%	8%	30%	Total
NPIF CT	85,085	–	–	10,947	96,032
KCLP	15,292	4,330	4,729	40	24,391
Miller LP	–	84	4,511	44,815	49,410
	100,377	4,414	9,240	55,802	169,833

The Fund's IFPC subsidiary has a UCC balance at December 31, 2006, of $30.5 million. However, as IFPC is not a flow-through entity (partnership or trust), IFPC's yearly capital cost allowance does not have a direct impact on the taxability of the Fund's distributions.

Distributions in 2007 are expected to be approximately 20% tax-deferred and 80% taxable to Unitholders.

Distribution and Funding Policy

It is the Fund's policy to maintain a prudent, sustainable level of distributions in relation to distributable cash, with excess cash being retained and held for reinvestment and future acquisitions. Any permitted acquisitions and plant expansions would be funded by a combination of cash on hand, borrowings and the issuance of additional securities of the Fund.

OUTLOOK

Management expects the Fund's 2007 financial results to be affected by many of the same factors as 2006's results. These factors include:

- **The Mont Miller wind farm will contribute a full year of operational results, which are expected to be closer to the Fund's long-term projections.**
- **Iroquois Falls' PPA rates in 2007 will continue to be positively affected by the higher electricity wholesale market prices that were experienced in Ontario during 2005 through the three-year averaging mechanism in the PPA discussed previously. Although the extreme summer weather experienced in 2005 may not be repeated in 2007, wholesale electricity prices are expected to remain under upward pressure as new generation contracted by the Ontario Power Authority becomes operational.**
- **The Kingston facility has forward sales contracts that were entered into when natural gas prices peaked in late 2005 that determine the price to be received for approximately 60% of its natural gas sales in 2007.**

The Manager expects management and administration costs to be lower in 2007 as certain 2006 expenditures were one-time in nature (acquisition fees for the Kingston and German acquisitions and legal costs relating to the Calpine bankruptcy and related backstop agreement and the Fund's internal reorganization in January 2007).

Distributions to Unitholders in 2007 are expected to continue at the level of $1.08 per unit established in 2006. The Manager of the Fund considers that a significant portion of the increase in distributable cash experienced in 2006 is sustainable as it was due to the results of its successful investments over the last few years. Management expects that distributable cash will again exceed the amount of distributions in 2007.

The Fund's strong financial position allows it to continue to seek acquisition opportunities that meet its criteria for increasing distributions while also protecting the Fund's current risk profile.

The Manager and Trustees of the Fund will continue to monitor the government's proposals to tax distributions and the impact on Unitholders. Adverse taxation changes may increase the Fund's cost of equity capital and negatively affect the Fund's ability to grow and make future acquisitions.

As discussed in the Fund's 2005 and 2006 annual reports, the parent of the Fund's Manager is developing a 150 MW wind power project located near Saint-Ulric/Saint-Léandre, Quebec, called Jardin d'Éole. At this time, the Fund's role in the project, if any, has not been determined.

Commitments/Contractual Obligations

In thousands of dollars	2007	2008	2009	2010	2011	>2011
Convertible subordinated debentures	1,903	1,903	1,903	1,903	30,234	–
Maintenance agreements	1,195	1,296	4,118	1,241	586	9,414
Debt	19,948	19,926	19,728	20,197	20,385	105,370
Natural gas transportation, fixed portion	22,002	21,606	22,039	22,479	22,930	121,541
Management fees	1,949	1,991	2,034	2,026	1,806	16,117
	46,997	46,722	49,822	47,846	75,941	225,442

The table above includes all fixed contractual obligations of the Fund and its subsidiaries. The amounts are based on the assumptions of a 2.0% annual consumer price index increase, a U.S. dollar/Canadian dollar exchange rate of $1.17 and euro/Canadian dollar exchange rate of $1.54. The table includes natural gas transportation demand charges, which are incurred whether or not natural gas is shipped; payments to GE by KCLP; base management fees to NPIFMI and the operations managers of the German wind farms; principal payments and interest due on Miller LP's and KCLP's term loan and senior secured notes; and Miller LP's fixed contractual obligations related to the five-year warranty, maintenance and services agreement with Vestas.

With the exception of the payments to GE by KCLP, the table does not include variable contractual obligations of the Fund (which typically relate directly to production or meeting performance criteria). Such obligations include natural gas purchase costs, variable natural gas transportation costs, payments to GE under the IFPC gas turbine service agreement and performance bonuses to NPIFMI. With respect to the PPAs for the supply of electricity, there are no penalties for failure to supply. With respect to the supply of natural gas, there are no penalties for failure to purchase natural gas under these contracts; however, failure to purchase specified annual quantities could reduce the delivery obligations of the suppliers.

Critical Accounting Estimates

A discussion of the Fund's significant accounting policies is contained in note 2 to the consolidated financial statements. Preparing financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities and expenses. The Fund's operations and investments operate under long-term contracts with highly credit-worthy counterparties. As a result, the Manager of the Fund believes it is not exposed to critical accounting estimates to the same degree as non-contracted operations of comparable size. For the Fund, the amounts recorded for amortization of property, plant and equipment, contracts and deferred charges and the amount provided for asset retirement obligations are based on estimates. Estimates were also made with respect to the fair value of the assets and liabilities acquired in KCLP on March 23, 2006, and the two German wind farms on April 25, 2006. An external valuation expert assisted the Manager with the estimation of the fair market value of the KCLP assets acquired. By their nature, these estimates are subject to measurement uncertainty, and changes in these estimates may affect the consolidated financial statements of future periods.

Asset Retirement Obligations

The Fund's Mont Miller facility was constructed on land leased from the Government of Quebec for a 25-year period with an option to extend the leases for an additional 15 years. Upon the expiration of the leases, the leased land must be returned to its original condition and all turbines dismantled. The majority of the costs are expected to be incurred in approximately 40 years once the original leases and 15-year extensions have expired.

The Fund's German wind farms are constructed on lands under leases that expire in 2030. The manager of the wind farms estimates that the net asset retirement obligation of the two German wind farms will be approximately $0.2 million at the expiration of the higher-price period under the German renewable energy legislation.

A credit-adjusted discount rate of 6.15% and an inflation rate of 2.50% were used to calculate the fair value of the asset retirement obligations. The Manager of the Fund periodically reviews the estimated costs of returning the leased lands to original condition at the end of the lease periods. Accordingly, revisions to the Fund's asset retirement obligations will be made as new information is received.

These asset retirement obligations relate solely to the Fund's wind facilities, as the Fund expects to use its other installed assets (the Iroquois Falls and Kingston facilities) for an indefinite period due to continuing equipment overhauls and ownership of the lands. As a result, no removal date can be determined, and consequently the Manager considers that a reasonable estimate of the fair value of any related asset retirement obligations cannot be made at this time.

Emerging Accounting Pronouncements

Financial Instruments

During 2005, the Canadian Accounting Standards Board ("AcSB") completed its project on the recognition and measurement of financial instruments by issuing new recommendations dealing with financial instruments and hedging and by introducing the concept of other comprehensive income. Under the new accounting standards, which come into effect in the first quarter of 2007, all financial instruments, including derivatives, must be included on a company's balance sheet and measured at fair value or, in limited circumstances when fair value may not be the most relevant basis, at cost or amortized cost. The standards also specify when gains and losses resulting from changes in fair value are to be recognized in the statement of income and deficit. Existing requirements for hedge accounting are to be extended and clarified. In addition, certain gains and losses will be reported as other comprehensive income.

Canadian Accounting Standards Board's Strategic Plan

On January 10, 2006, the AcSB ratified a new strategic plan that will significantly affect the way financial reporting will be carried out in Canada. The plan entails converging Canadian generally accepted accounting principles with International Financial Reporting Standards over an expected five-year transitional period. The AcSB will develop and publish a detailed implementation plan for achieving convergence. At the end of that period, Canadian GAAP will cease to exist as a separate, distinct basis for financial reporting for public companies.

Neither of the above-mentioned emerging accounting pronouncements will have an impact on the Fund's cash or distributable cash.

Controls and Procedures

Disclosure Controls and Procedures

Disclosure controls and procedures are designed to provide reasonable assurance that all relevant information is gathered and reported to senior management of the Manager, including the CEO and CFO, on a timely basis so that appropriate decisions can be made regarding public disclosure.

An evaluation of the effectiveness of the design and operation of the Fund's disclosure controls and procedures was conducted as of December 31, 2006, by and under the supervision of the Manager, including the CEO and CFO. Based on this evaluation, the CEO and CFO have concluded that the Fund's disclosure controls and procedures, as defined in Multilateral Instrument 52-109, Certification of Disclosure in Issuers' Annual and Interim Filings, are effective to ensure that information required to be disclosed in reports that are filed or submitted under Canadian securities legislation is recorded, processed, summarized and reported within the time periods specified in those rules and forms.

Internal Control Over Financial Reporting

The Manager of the Fund is responsible for establishing and maintaining adequate internal control over financial reporting to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with GAAP. The Manager, including the CEO and CFO, assessed the design of the Fund's internal control over financial reporting as at December 31, 2006, and based on that assessment determined that the Fund's internal control over financial reporting provides reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements in accordance with GAAP.

No changes were made in the Fund's internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, the Fund's internal control over financial reporting in the quarter ended December 31, 2006.

Risks and Uncertainties

The risks and uncertainties discussed below highlight the more important and relevant factors that could significantly affect the Fund's operations. They do not represent an exhaustive list of all potential issues that could affect the financial results of the Fund and its subsidiaries.

Contracts and Counterparties

The amount distributed by the Fund to Unitholders is dependent upon the parties to the Fund's long-term contracts continuing to fulfill their contractual obligations. In particular, as electricity sales represent a majority of IFPC's and KCLP's revenues and all of Miller LP's revenues, failure of OEFC or Hydro-Québec to meet its contractual obligations would have an adverse affect on distributions. A portion of the Fund's distributable cash originates from interest and principal payments on the senior loan to PIC and dividends from PEC that are dependent, in part, upon the parties to PEC's subsidiaries' long-term contracts continuing to fulfill their contractual obligations. In particular, failure of Potomac Electric Power Company to meet its obligations could have an adverse effect on distributions.

Both the Iroquois Falls PPA and the Kingston PPA provide for certain rights to OEFC to curtail electricity output during the summer. OEFC has generally availed itself of those rights at the Iroquois Falls facility but not at the Kingston facility. Should OEFC exercise its curtailment rights at KCLP, the Fund's distributable cash would not be materially affected as these electricity revenues would be offset by gas resale revenues.

The Ontario government enacted the Electricity Restructuring Act, 2004, in December 2004, which may have a significant impact on Ontario's electricity markets and therefore on opportunities available to IFPC for sales of electricity and ancillary products outside the PPA. The Manager is unable to assess any potential impact until the Ontario government clarifies its position with respect to the future of the wholesale electricity market. However, OEFC has confirmed that the Iroquois Falls agreement in principle respecting certain amendments to

the Iroquois Falls PPA reached in 2002 will not be affected by this measure. Although the boards of trustees and directors of NPIF Commercial Trust and OEFC, respectively, approved the agreement in principle, a definitive agreement containing provisions of the agreement in principle has yet to be completed and, when it is, will be subject to the approval of both boards. Failure to achieve a final, approved definitive agreement could have an impact on the provisions of the Iroquois Falls PPA, including those provisions relating to the index used to adjust revenues from electricity sales.

Steam sales by both the Iroquois Falls and Kingston facilities constitute a secondary source of revenue for the Fund. Abitibi's demand for steam is determined by operations at its Iroquois Falls pulp and paper mill, including the level of its own steam production. The Iroquois Falls facility is obliged to respond to fluctuations in Abitibi's steam needs. Demand for steam has an impact on gas consumption, and unexpectedly large short-term fluctuations in steam demand increase natural gas consumption without a proportionate increase in steam revenue. Since May 2003, Abitibi has not been obligated to pay for a minimum quantity of steam. However, since January 1, 2002, the Fund has been protected through provisions of the Iroquois Falls PPA that increase OEFC's electricity purchase obligations to make up for shortfalls in steam revenue.

KCLP provides steam to an adjacent plant owned by INVISTA under an energy services agreement. If a force majeure event occurs, such as a strike or lockout, INVISTA will not be required to purchase any steam from KCLP or to compensate KCLP.

KCLP has a long-term contract with INVISTA for the supply of water to the Kingston facility from Lake Ontario through INVISTA's pumphouse. If a force majeure event occurs, such as a strike or lockout, INVISTA may discontinue the supply of water. KCLP has the right to physically access INVISTA's pumphouse and any other equipment necessary to draw sufficient amounts of water for the Kingston facility.

Legal Contingencies

The Fund and its subsidiaries may be named as a defendant in various claims and legal actions. Exposure to these claims is mitigated through levels of insurance coverage considered appropriate by management. Management does not expect the outcome of claims or potential claims to have a materially adverse effect on the Fund. Details on the Fund's litigation, claims and contingencies are outlined in note 23 of the audited consolidated financial statements.

Qualifying Facility Status of Panda-Brandywine

If the Panda-Brandywine facility were to lose its status as a qualifying facility, then it would no longer be entitled to an exemption from the United States Public Utility Holding Company Act of 1935, as amended. Loss of qualifying facility status could trigger defaults under covenants to maintain qualifying facility status in the PPA and project-level debt agreement and result in termination, penalties or acceleration of indebtedness under such agreements, plus interest. Accordingly, the ability of PIC to meet its repayment obligation under the PIC senior loan is dependent on the Panda-Brandywine facility maintaining its qualifying facility status.

Natural Gas Supply, Transportation and Price

Contracted natural gas prices for the Iroquois Falls facility generally escalate with the new replacement electricity selling price index under the agreement in principle with OEFC respecting certain amendments to the Iroquois Falls PPA, subject to a 4% minimum annual increase. The gas contracts, with expiration dates in 2015 and 2016, provide for price adjustments (subject to predefined ceilings) approximately every five years for which 50% of any resulting incremental costs are borne by OEFC. Alternatively, the periodic gas price adjusters could decrease contracted gas prices relative to electricity prices; OEFC shares in approximately 40% of any such savings. KCLP has a natural gas purchase agreement with EnCana Corporation for the supply of natural gas until 2017. The gas costs escalate with transportation costs on the NOVA system and a predetermined amount over the Canadian consumer price index. Failure by IFPC's or KCLP's natural gas suppliers to provide gas under the long-term contracts could result in higher gas prices if either was forced to make market purchases. Upon expiry of the above contracts, IFPC and KCLP will be required to renegotiate their respective contracts or enter into new gas supply arrangements. There is no assurance as to the price of natural gas under any new arrangements.

Any failure by TransCanada PipeLines or Union Gas Limited or any of the contracted natural gas suppliers to supply or deliver natural gas to the Iroquois Falls facility or the Kingston facility will have an adverse impact on cash distributions.

The Panda-Brandywine facility has contracted for most of its natural gas supply and transportation services on an interruptible basis because it is partially dispatched as a peaking plant with the bulk of its dispatch hours occurring during the summer months when operational experience suggests that gas typically will be available for purchase. Interruptible gas supply and transportation arrangements are subject to interruption or curtailment during periods of peak demand for natural gas. If the power purchaser were to significantly increase its dispatch of the Panda-Brandywine facility during periods of natural gas supply curtailment, backup fuel will permit electricity production but potentially at a higher cost.

Operational

The Fund's facilities, comprising the Iroquois Falls, Kingston and Panda-Brandywine cogeneration plants and the Mont Miller and German wind farms, are subject to operational risks that could have an adverse effect on cash distributions, including premature wear or failure of major equipment due to defects in design, material or workmanship. The risks associated with the Fund's cogeneration facilities are partially mitigated by the proven nature of the technology and design of the facilities, the availability of critical spares on site, the gas turbine maintenance agreement in respect of the Iroquois Falls and Kingston facilities with GE and participation by IFPC in the GE gas turbine lease pool that guarantees the availability of replacement gas turbines on short notice. The risks associated with the operations of the Mont Miller and German wind farms are partially mitigated by the maintenance and service agreements with the original equipment suppliers.

Under the Iroquois Falls PPA, if IFPC delivers less than 80% of the on-peak target quantities in a month, the monthly capacity payment (which is the largest component of the monthly payment) will be reduced by 6.66% for each 1% less than 80%. No capacity payment will be paid for a month in which the Iroquois Falls facility delivers less than 65% of the on-peak target quantities.

The Kingston PPA states that if KCLP delivers less than 80% of the on-peak target quantities, no capacity payment will be paid. However, if there is an event of force majeure at the Kingston facility (which is defined to include equipment failure that lasts longer than four days), the number of on-peak hours used to calculate the target generation will be reduced by the number of on-peak hours in the period of force majeure during that month.

The Panda-Brandywine facility is dependent on capacity payments due from Potomac Electric Power Company under its PPA. Capacity payments payable by Potomac Electric Power Company would be reduced if the Panda-Brandywine facility cannot sustain 88% equivalent availability.

The PPA with respect to the Mont Miller wind farm has no minimum or maximum production or delivery requirement and no capacity payment. Similarly, German legislation governing payments to qualifying wind farms, such as the Fund's German wind farms, contains no such obligations.

Variability of Wind-Based Revenue

The wind speeds at the Fund's wind farms will vary. Although the Fund believes that the wind survey and historical production data that has been collected demonstrates that the sites are economically viable, weather patterns could change or the historical data and technical predictions could prove not to reflect accurately the strength and consistency of the wind in the future. If there is insufficient wind, the underlying financial projections regarding the amount of electricity to be generated by the wind farms may not be met, and distributable cash could be materially adversely affected.

The German wind farms receive revenue in accordance with German renewable energy legislation, which has rates above market. There is no guarantee that this legislation will not be changed such that the amount of revenue generated would be less than currently received.

Variability of Distributions

The actual amount of cash distributions to Unitholders will depend on numerous factors, including the financial performance of the Fund's operations, the ability to meet debt covenants and obligations, working capital requirements, future capital requirements and tax-related matters. The market value of the trust units may deteriorate if the Fund is unable to maintain its cash distribution levels in the future, and that deterioration may be material.

Environment, Health and Safety

The Fund's facilities are subject to numerous and significant laws, including statutes, regulations, bylaws, guidelines, policies, directives and other requirements governing or relating to, among other things, air emissions; discharges into water; the storage, handling, use, transportation and distribution of dangerous goods and hazardous and residual materials, such as chemicals; the prevention of releases of hazardous materials into the environment; the prevention, presence and remediation of hazardous materials in soil and groundwater, both on and off site; land use and zoning matters; and workers' health and safety matters. As such, the operation of the facilities carries an inherent risk of environmental, health and safety liabilities (including potential civil actions, compliance or remediation orders, fines and other penalties) and may result in the facilities being involved from time to time in administrative and judicial proceedings relating to such matters, which could have a materially adverse effect on the Fund's business, financial condition and results of operations.

All current generating equipment at IFPC and KCLP is designed to produce NOx emissions below the current applicable standards. Ontario legislation that came into effect in 2004 introduced a cap and trade system with respect to NOx emissions. Installation of the new gas turbines at the Iroquois Falls facility in 2003 reduced NOx emissions well below the levels specified by the new legislation. NOx emissions from KCLP's existing generating equipment fall well below those levels.

Although the Manager believes the operations of each of the facilities are currently in material compliance with applicable environmental laws, licences, permits and other authorizations required for the operation of the facilities and although there are environmental monitoring and reporting systems in place with respect to all facilities, there is no guarantee that more stringent laws or regulations will not be imposed, that there will not be more stringent enforcement of applicable laws or that such systems will not fail, which may result in material expenditures. Failure by the facilities to comply with any environmental, health or safety requirements or increases in the cost of such compliance, which could be a result of unanticipated liabilities or expenditures for investigation, assessment, remediation or prevention, could possibly result in additional expense, capital expenditures, restrictions and delays in the facilities' activities, the extent of which cannot be predicted.

Insurance

There can be no assurance that insurance obtained in respect of the Fund's facilities, including business interruption insurance, among others, will be sufficient or will continue to be offered on commercially reasonable terms or that events that could give rise to a loss or liability are insured or reasonably insurable.

Tax-Related Risks

There can be no assurance that Canadian or United States income tax laws and government incentive programs respecting the treatment and status of mutual fund trusts will not be changed in a manner that adversely affects the Fund and Unitholders.

The Fund has taken the position that interest payments on the senior loan made to PIC from IFPC qualify for exemption from U.S. withholding tax as "portfolio interest." PEC claims a deduction of interest paid to IFPC under the PIC senior loan in computing its income for United States federal income tax purposes. There is a risk that the U.S. Internal Revenue Service (IRS) could successfully challenge these positions, in which case the portfolio interest exemption from U.S. withholding tax would not apply and otherwise deductible interest on the senior loan would be treated as non-deductible distributions. If interest received from PIC is subject to withholding tax, management estimates that the impact on an annual basis would be approximately $1.2 million in taxes.

On October 31, 2006, the Canadian federal government announced tax proposals pertaining to taxation of distributions paid by income trusts and changes to the personal tax treatment of trust distributions that will be applicable starting in 2011. While legislation was introduced on December 21, 2006, the government's proposals remain draft and have not passed into law.

Currently, the Fund does not pay income tax as long as distributions to Unitholders exceed the amount of the Fund's income that would otherwise be taxable; Canadian Unitholders who receive the distributions personally (i.e., outside an RRSP or other tax-deferral plan) are liable for income tax on the taxable portion of distributions at full personal tax rates. The new proposed law would result in a two-tiered tax structure similar to that of corporations whereby the taxable portion of distributions would be subject to income tax payable by the Fund at a rate of 31.5% while taxable Canadian Unitholders would receive the favourable tax treatment on distributions currently applicable to qualifying dividends. If the law is enacted as drafted, there would be essentially no impact on the cash flow of taxable Canadian Unitholders arising from these changes as the new tax payable by the Fund would be offset by the reduced rate of tax applicable to dividends.

At present, Canadian registered pension plans, RRSPs and RRIFs ("Canadian tax-exempt entities") are not subject to current income tax on distributions received from the Fund (their tax obligation is deferred). Under the new proposed law, Canadian tax-exempt entities would receive distributions after provision by the Fund for the new tax, as will investors located outside Canada. The tax proposals, if enacted as drafted, are likely to increase the Fund's cost of equity capital, which may negatively affect its ability to grow and make future acquisitions.

In addition to the foregoing, the Fund is subject to various additional uncertainties concerning the interpretation and application of Canadian and U.S. tax laws that could affect the Fund's profitability and cash flows.

Currency Fluctuations

The Fund receives cash flows in U.S. dollars from the investment in PEC and the loan to PIC that exceed the amount of payment obligations in U.S. dollars, primarily related to the service agreeements for the gas turbines at Iroquois Falls and Kingston. Exchange rate fluctuations between the U.S. and the Canadian dollar may affect the cash flow of the Fund, NPIF Commercial Trust or IFPC. The Fund has entered into foreign exchange forward contracts in respect of a substantial portion of the interest and principal payments to be received on the PIC senior loan from 2007 to 2009. In 2006, the Fund benefited by $1.5 million in aggregate by having foreign exchange option contracts compared to the alternative of converting U.S. dollar payments as received at the average spot exchange rate for the year of US$1.13 per CA$1.00.

The Fund also receives semi-annual cash flows in euros from its investment in Germany. Exchange rate fluctuations between the euro and the Canadian dollar may affect the cash flow of the Fund or NPIF Commercial Trust. To partially mitigate its exposure to exchange rate fluctuations between the euro and the Canadian dollar, the Fund entered into foreign exchange forward contracts in respect of its net investment in the German wind farms that fix the exchange rate for a substantial portion of the interest and principal payments to be received from its German subsidiaries to 2011. The Fund is obligated to make delivery of U.S. dollars and euros at the stated amounts on a quarterly and semi-annual basis, respectively, on each of the forward contracts even if the PIC loan payments or the euro loan repayments are not made. This would require the Fund to purchase U.S. dollars or euros on the open market at the relevant time. To the extent that the Fund, NPIF Commercial Trust and IFPC have engaged in risk-management activities related to the U.S. and Canadian dollar and euro and Canadian dollar exchange rates, the Fund may not benefit from favourable exchange rate movements and could become subject to credit risks associated with the counterparties with which it contracts.

Labour Relations

Employees at the Iroquois Falls facility are unionized. The current labour agreement with these employees lasts until June 30, 2010. In the event of a strike or lockout, the ability of IFPC to operate may be limited and its ability to generate cash for distributions may be impaired. Employees at the Fund's other facilities are not unionized.

Reliance on Third Parties

The Fund is reliant upon the Manager for the administration and management of all matters relating to the Fund. The Fund is reliant on Panda Global Services Inc. with respect to the management of the Panda-Brandywine facility and enXco GmbH with respect to the management of the German wind farms.

Potential Conflicts of Interest

There may be situations in which the interests of the parent of the Manager, Northland Power Inc. (NPI), or its affiliates other than the Manager will conflict with those of IFPC, NPIF Commercial Trust, KCLP, Miller LP, the German wind farms, PEC, its subsidiaries or the Unitholders. NPI may engage in activities similar to the current activities of IFPC, KCLP, Miller LP, the German wind farms, PEC and its subsidiaries. NPI may acquire, own, manage and administer other power generation facilities. The Manager may carry on its activities on behalf of companies other than those in which the Fund has invested and may be in competition with them.

Management's Responsibility

Preparation of the financial statements and the annual report of Northland Power Income Fund ("the Fund") is the responsibility of the management of Northland Power Income Fund Management Inc. ("the Manager") as administrator of the Fund and manager of the Fund's wholly owned subsidiaries, including NPIF Commercial Trust, Iroquois Falls Power Corp. (IFPC), Kingston CoGen Limited Partnership (KCLP) and Mount Miller Wind Energy Limited Partnership ("Miller LP").

The accompanying consolidated financial statements have been prepared by the Manager in accordance with Canadian generally accepted accounting principles, and the financial information included in the annual report is consistent with the consolidated financial statements. Where appropriate, these consolidated financial statements reflect estimates based on judgments of the Manager. When alternative methods exist, the Manager has chosen those it deems most appropriate in the circumstances in order to ensure that the consolidated financial statements are presented fairly, in all material respects.

The Manager is responsible for the development and maintenance of systems of internal accounting and administrative cost controls of high quality, consistent with a suitable cost. Such systems are designed to provide reasonable assurance that the financial information is accurate, relevant and reliable and that the Fund and its subsidiaries' assets are appropriately accounted for and adequately safeguarded.

The Board of Trustees of NPIF Commercial Trust is responsible for reviewing the consolidated financial statements of the Fund and the accompanying management's discussion and analysis and ensuring that the Manager fulfills its contractual responsibilities for financial reporting. The Board of Trustees carries out this responsibility principally through the Audit Committee, which it appoints and is composed solely of trustees independent of the Manager.

Ernst & Young LLP, the independent auditors, have examined the consolidated financial statements of the Fund. The independent auditors' responsibility is to express a professional opinion on the fairness of the consolidated financial statements. The auditors' report outlines the scope of their examination and sets forth their opinion on the consolidated financial statements. Their report as auditors is set out on page 44.

The Audit Committee meets periodically with the Manager and the independent auditors to discuss internal controls, auditing matters and financial reporting issues and to satisfy itself that each party is properly discharging its responsibilities. The Audit Committee also reviews the consolidated financial statements, management's discussion and analysis and the external auditors' report; examines the fees and expenses for audit services; and considers the engagement or reappointment of the external auditors. The Audit Committee reports its findings to the Board of Trustees for consideration prior to the issuance of the consolidated financial statements to the Unitholders. Ernst & Young LLP have full access to the Audit Committee and meet with the committee both in the presence of the Manager and separately.

John W. Brace
President and CEO
Northland Power Income Fund Management Inc.

Anthony F. Anderson
Chief Financial Officer
Northland Power Income Fund Management Inc.

Auditors' Report

To the Unitholders of Northland Power Income Fund

We have audited the consolidated balance sheets of Northland Power Income Fund as at December 31, 2006 and 2005, and the consolidated statements of income and deficit and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Manager of the Fund. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with Canadian 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, 2006 and 2005, and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Ernst & Young LLP

Toronto, Canada
February 15, 2007

Chartered Accountants

Consolidated Balance Sheets

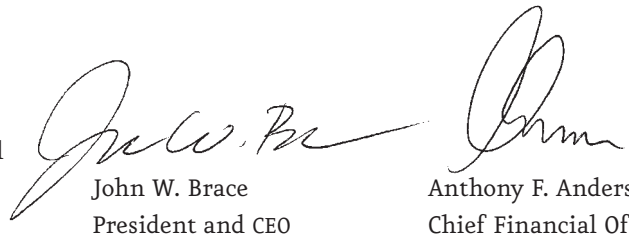
As at December 31,

in thousands of dollars

Assets	2006	2005
Current		
Cash and cash equivalents	**13,484**	14,482
Cash reserves [note 11]	**1,664**	413
Accounts and other receivables [note 3]	**30,380**	23,090
Inventories [note 4]	**9,598**	5,760
Prepaid expenses	**1,907**	1,854
Current portion of senior loan receivable [note 10]	**2,710**	2,797
Total current assets	**59,743**	48,396
Deferred charges [note 5]	**4,766**	5,420
Property, plant and equipment, net [note 6]	**434,928**	386,156
Contracts, net [note 7]	**142,729**	18,077
Investment in Panda Energy Corporation [note 10]	**7,946**	7,946
Senior loan receivable [note 10]	**79,042**	81,454
Future income tax asset [note 20]	**1,404**	1,401
	730,558	548,850
Liabilities and Unitholders' equity		
Current		
Accounts payable and accrued liabilities	**13,632**	8,239
Current portion of Kingston CoGen debt [note 11]	**8,008**	4,488
Current portion of Mont Miller term loan [note 13]	**951**	808
Distribution payable to Unitholders	**6,701**	5,685
Total current liabilities	**29,292**	19,220
Bank credit facility [note 12]	**5,000**	–
Kingston CoGen debt [note 11]	**85,033**	62,260
Mont Miller term loan [note 13]	**38,241**	39,192
Other long-term liabilities [note 14]	**9,715**	331
Asset retirement obligation [note 15]	**2,935**	2,687
Convertible debentures [notes 16 and 17]	**29,282**	46,058
	199,498	169,748
Commitments and contingencies [notes 11, 12, 20 and 21]		
Trust units [note 17]	**670,184**	487,583
Cumulative translation adjustment	**145**	–
Deficit	**(139,269)**	(108,481)
Total Unitholders' equity	**531,060**	379,102
	730,558	548,850

See accompanying notes.

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



John W. Brace
President and CEO

Anthony F. Anderson
Chief Financial Officer

Consolidated Statements of Income and Deficit

Years ended December 31, in thousands of dollars, except per unit and unit information

	2006	2005
Sales		
Electricity	**130,725**	101,889
Steam	**9,234**	7,280
Natural gas	**24,622**	17,903
Emission allowances	**210**	1,106
Total sales	**164,791**	128,178
Cost of sales	**66,070**	51,040
Gross profit	**98,721**	77,138
Expenses		
Plant operating costs	**14,920**	10,906
Amortization of property, plant and equipment	**25,355**	17,097
Management and administration costs	**11,111**	4,863
Accretion expense [note 15]	**174**	79
	51,560	32,945
Investment income [note 10]	**11,123**	15,047
Income from operations	**58,284**	59,240
Foreign exchange	**(26)**	2,185
Amortization of deferred charges [note 5]	**654**	1,284
Amortization of contracts [note 7]	**11,532**	1,120
Interest income	**(840)**	(478)
Interest expense and bank fees	**13,700**	10,458
Income before income taxes	**33,264**	44,671
Provision for (recovery of) income taxes [note 20]		
Current	**(588)**	611
Future	**(297)**	(261)
	(885)	350
Net income for the year	**34,149**	44,321
Deficit, beginning of year	**(108,481)**	(101,701)
Distributions declared to Unitholders [note 18]	**(64,937)**	(51,101)
Deficit, end of year	**(139,269)**	(108,481)
Average number of units outstanding – basic (000s)	**59,311**	48,551
Average number of units outstanding – diluted (000s)	**62,395**	53,438
Net income per trust unit – basic	**$0.58**	$0.91
Net income per trust unit – diluted	**$0.58**	$0.87

See accompanying notes.

Consolidated Statements of Cash Flows

Years ended December 31,

in thousands of dollars

	2006	2005
Operating activities		
Net income for the year	**34,149**	44,321
Items not involving cash:		
Amortization of property, plant and equipment	**25,355**	17,097
Amortization of deferred charges [note 5]	**654**	1,284
Amortization of contracts [note 7]	**11,532**	1,120
Future income taxes [note 20]	**(297)**	(261)
Accretion expense [note 15]	**174**	79
Other long-term liabilities [note 14]	**425**	331
Foreign exchange	**(26)**	2,185
	71,966	66,156
Net change in non-cash working capital balances related to operations	**(1,399)**	(10,530)
Cash provided by operating activities	**70,567**	55,626
Investing activities		
Cash reserves drawdown (funding) [note 11]	**(835)**	1,524
Investment in German wind farms [note 8]	**(25)**	–
Purchase of German receivables from vendors [note 8]	**(3,879)**	–
Receipts of principal on senior loan [note 10]	**2,793**	25,040
Net change in non-cash working capital balances related to Mont Miller	**–**	10,673
Investment in Kingston CoGen [note 11]	**(117,798)**	–
Deferred charges [note 5]	**–**	(225)
Wind-up and restructuring fees [notes 5 and 10]	**–**	1,890
Purchase of property, plant and equipment	**(152)**	(25,901)
Cash provided by (used in) investing activities	**(119,896)**	13,001

continued...

Years ended December 31,

in thousands of dollars

	2006	2005
Financing activities		
Kingston CoGen repayment of debt [note 11]	**(38,815)**	(2,614)
Prospectus receipts, net [note 17]	**165,825**	–
Proceeds from (repayment of) Mont Miller term loan [note 13]	**(808)**	17,000
Credit facility increase (decrease) [note 12]	**5,000**	(37,300)
Repayment of German debt [note 8]	**(18,965)**	–
Distributions to Unitholders	**(63,921)**	(49,848)
Cash provided by (used in) financing activities	**48,316**	(72,762)
Effect of exchange rate differences on cash and cash equivalents	**15**	–
Net change in cash and cash equivalents during the year	**(998)**	(4,135)
Cash and cash equivalents, beginning of year	**14,482**	18,617
Cash and cash equivalents, end of year	**13,484**	14,482
Cash and cash equivalents consist of		
Cash	**12,174**	5,998
Short-term investments	**1,310**	8,484
Supplemental cash flow information		
Interest paid	**13,254**	10,904
Income taxes paid	**47**	552

See accompanying notes.

December 31, 2006

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. The objective of the Fund is to produce stable and sustainable levels of cash available for distribution to its Unitholders from energy-related businesses.

Northland Power Income Fund indirectly owns interests in six power generating facilities: three natural-gas-fired combined-cycle cogeneration power plants that efficiently and cleanly produce electricity and steam for sale and three wind farms. Two cogeneration plants are located in Ontario: the 120 MW Iroquois Falls facility, which has been wholly owned by the Fund since its inception in 1997, and the 110 MW Kingston facility, which has been wholly owned by the Fund since it acquired the remaining 50% interest on March 23, 2006 (note 11). Through its 19% equity interest in Panda Energy Corp. (PEC) and loan to a PEC subsidiary (PIC) (note 10), the Fund has an interest in the 230 MW Panda-Brandywine cogeneration plant located outside Washington, D.C. Sales of electricity produced from the cogeneration plants are made under long-term power purchase agreements (PPAs) with creditworthy customers to ensure revenue stability, and long-term contracts assure the supply and price of natural gas, which is the Fund's largest cost. The 54 MW Mont Miller wind farm in the Gaspésie region of Quebec supplies electricity to Hydro-Québec. The Fund also owns two wind farms in Germany with a total capacity of 21.5 MW, where the electricity is sold to regional power utilities under the provisions of German renewable energy legislation.

The Iroquois Falls facility's sales are seasonal, as Ontario Electricity Financial Corporation (OEFC) has contracted for more electricity (and pays a higher price) in winter than in summer. In addition, steam sales tend to be higher in winter than summer. Financial results from the Fund's wind farms are expected to follow a similar seasonal pattern as Iroquois Falls, as it tends to be windier in the winter months compared to the summer months. Seasonality has been dampened somewhat as the financial results for the Kingston facility, in which the Fund invested on December 31, 2002, December 15, 2004, and March 23, 2006, are less seasonal than Iroquois Falls.

Net income also includes interest earned on the senior loan receivable from a PEC subsidiary, dividends received from the Fund's 19% equity interest in PEC (neither of which varies materially by season) and any non-cash foreign exchange adjustments required to translate the U.S.-dollar-denominated balance of the senior loan to the appropriate quarter-end Canadian dollar equivalent.

2. Summary of Significant Accounting Policies

These consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles (GAAP) and within the framework of the significant accounting policies summarized as follows:

Principles of consolidation

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

The Fund's investment in PEC is accounted for under the cost method. Under the cost method of accounting, investments are carried at cost and are adjusted only for other-than-temporary declines in fair value, distributions of capital and additional investment.

Cash and cash equivalents

Cash equivalents comprise only highly liquid investments with original maturities of less than 90 days at the date of acquisition and are recorded at cost, which approximates market value.

Use of estimates

The preparation of consolidated financial statements in conformity with Canadian GAAP requires that Northland Power Income Fund Management Inc. ("the Manager"), the administrator of the Fund and the manager of the Iroquois Falls, Kingston and Mont Miller facilities, as well as the managers of the Panda-Brandywine cogeneration plant and the two German wind farms, make estimates and assumptions about future events that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the dates of the consolidated financial statements, and revenue and expenses during the reporting period. Actual results could differ from those estimates.

Inventories

Inventories comprise natural gas, spare parts and other inventory. Natural gas is carried at the lower of cost, as determined on a weighted average basis, or net realizable value. Spare parts and other inventory are carried at the lower of cost or net replacement cost.

Property, plant and equipment

Property, plant and equipment are recorded at cost less accumulated amortization. Amortization is provided on a straight-line basis at rates designed to amortize the cost of the assets over their estimated useful lives as follows:

Buildings and foundations	30 to 40 years
Plant and equipment	10 to 30 years
Vehicles	5 years
Office equipment, furniture and fixtures	5 years
Computers and computer software	2 years

Assets included in construction in progress are not amortized until the assets have entered into commercial operations. Interest costs incurred as a result of the construction and installation of the assets are included in construction in progress.

Contracts

Contracts relate to the fair value of the power purchase agreements, natural gas purchase agreements and steam sales agreements of the operating entities when they were acquired by the Fund and are recorded net of accumulated amortization. Contract amortization is provided on a straight-line basis over the term of the agreements.

Revenue recognition

Revenue for electricity, steam and natural gas sales is recognized upon delivery. A portion of the electricity sold under long-term PPAs is subject to retroactive adjustments for certain market-based escalation indices. Management estimates and records the impact of these retroactive adjustments to the escalation indices monthly and records adjustments, if any, in the month the retroactive payment is determined by OEFC. Interest and investment income is recognized as it is earned. Revenue from emission allowances is recognized upon the passage of title to the purchaser.

Net income per trust unit

The calculation of basic net income per trust unit is based on the consolidated net income for the year divided by the weighted average number of trust units outstanding during the year, which was 59,310,753 (2005 – 48,551,292). Diluted net income per unit is calculated by dividing consolidated net income, plus the interest expense relative to the debt that is being converted, by the weighted average number of units used in the basic net income per unit calculation plus the number of units that would be issued assuming conversion of the convertible unsecured subordinated debentures into trust units of the Fund.

Foreign currency translation

Self-sustaining foreign operations

The Fund's German operations are classified as self-sustaining operations for accounting purposes and are translated into Canadian dollars using the current rate method. Under this method, assets and liabilities are translated at exchange rates in effect at the balance sheet date and revenue and expenses are translated at the average exchange rates for the period. Exchange gains or losses arising from the translation and foreign currency forward contracts that have been designated as a hedge of the net investment in self-sustaining foreign operations are included in the cumulative translation adjustment account, which is a separate component of Unitholders' equity. An appropriate portion of the exchange gains and losses accumulated in the cumulative translation adjustment account will be included in the determination of income when there is a reduction in the net investment by way of a reduction in equity or through the settlement of a long-term inter-entity balance that has been considered part of the Fund's net investment.

Foreign currency transactions

Monetary assets and liabilities denominated in foreign currencies are translated at exchange rates prevailing at the balance sheet date. Revenues and expenses denominated in foreign currencies are translated at the exchange rate prevailing at the dates of the respective transactions and reflect the impact of any derivative financial instruments entered into by the Fund as hedges of the underlying transactions.

Derivative financial instruments

The Fund and its subsidiaries enter into foreign exchange forward and option contracts to manage exposures resulting from foreign exchange fluctuations in the ordinary course of business. To the extent that the contracts are identified for hedge accounting, unrealized gains and losses on outstanding contracts are deferred until realized. The realized gains and losses are included in income and recognized as an adjustment to the underlying transaction.

The Manager of the Fund determines which derivative financial instruments are effective as hedges, both at inception and over the term of the instrument.

Interest rate swap contracts were entered into by Kingston CoGen Limited Partnership (KCLP) in order to hedge rate risk on currently outstanding debt. The interest rate differentials paid or received under such contracts are recognized over the life of the contracts as adjustments to interest expense on long-term debt in the period incurred.

The Fund does not engage in trading or other speculative activities with respect to derivative financial instruments. The fair value of derivative financial instruments reflects the estimated amount that the Fund would have been required to pay if forced to settle all unfavourable outstanding contracts or the amount that would be received if forced to settle all favourable contracts at year-end. The fair value represents a point-in-time estimate that may not be relevant in predicting the Fund's future earnings or cash flows. The Fund is exposed to credit risk in the event of non-performance by its counterparties. However, the Fund does not anticipate non-performance by its counterparties, as the counterparties have a high credit rating.

The carrying value of financial instruments, including derivative financial instruments, approximates fair value except where indicated.

Income taxes

The Fund follows the liability method of tax allocation, whereby future tax assets and liabilities are determined based on differences between the financial reporting and tax bases of assets and liabilities and are measured using the substantially enacted tax rates and laws that will be in effect when the differences are expected to reverse.

Under the terms of the Income Tax Act (Canada), the Fund, excluding its corporate subsidiaries, is not subject to income taxes to the extent that its taxable income in a year is paid or payable to a Unitholder. Accordingly, no provision for current income taxes for the Fund is made. In addition, the Fund is not required to apply the recommendations of the Canadian Institute of Chartered Accountants Handbook (CICA) section 3465, as the Fund is contractually committed to distribute to its Unitholders all or virtually all of its taxable income and taxable capital gains that would otherwise be taxable in the Fund. The Fund intends to continue to meet the requirements under the Income Tax Act applicable to such trusts.

Certain of the Fund's wholly owned subsidiaries are subject to corporate income taxes as computed under the Income Tax Act and CICA section 3465.

Impairment of long-lived assets

The Fund reviews long-lived assets such as property, plant and equipment and contracts for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. When indicators of impairment of the carrying value exist, an impairment loss on long-lived assets to be held and used is recognized. The amount of the impairment loss is determined as the excess of the carrying value of the asset over its fair value.

Asset retirement obligations

The Fund recognizes liabilities for obligations associated with the retirement of property, plant and equipment when those obligations result from the acquisition, construction, development or normal operations of the assets. The Fund's asset retirement obligations relate solely to the Fund's wind farms. As the Fund expects to use its other installed assets for an indefinite period due to continuing overhauls and ownership of the lands, no removal date can be determined.

3. Economic Dependence and Concentration of Credit Risk

The Fund is dependent on lease income, interest income, dividends, distributions and loan repayments received. In 2006, approximately 72% (2005 – 75%) of the Fund's consolidated revenue was derived indirectly from the sale of electricity to OEFC.

Approximately 81% (2004 – 81%) of the year-end accounts receivable balance was due from OEFC relating to electricity sales.

4. Inventories

Inventories consist of the following:

In thousands of dollars	**2006**	2005
Natural gas	**653**	447
Spare parts and other inventory	**8,945**	5,313
	9,598	5,760

5. Deferred Charges

Deferred charges consist of the following:

In thousands of dollars	**2006**	2005
Senior loan receivable transaction costs	**601**	685
Convertible subordinated debenture transaction costs	**2,128**	2,593
Mont Miller development costs	**2,037**	2,142
	4,766	5,420

Deferred charges are amortized on a straight-line basis as follows:

- Senior loan receivable transaction costs: over the term of the senior loan;
- Convertible subordinated debenture transaction costs: over the term of the convertible subordinated debentures; and
- Mont Miller development costs: over the term of the PPA.

During 2005, the Fund received $1.9 million in wind-up and restructuring fees related to a principal prepayment from PEC (see note 10). These fees were applied against the deferred senior loan receivable transaction costs. In addition, a one-time amortization adjustment of $0.7 million was recorded against the senior loan receivable transaction costs to reflect the accelerated principal prepayment.

6. Property, Plant and Equipment

Property, plant and equipment consist of the following:

In thousands of dollars	**2006**		2005	
	Cost	**Accumulated amortization**	Cost	Accumulated amortization
Land	**616**	**–**	371	–
Buildings and foundations	**131,850**	**40,826**	81,767	22,349
Plant and equipment	**485,770**	**142,516**	413,745	87,416
Vehicles	**26**	**26**	26	26
Office equipment, furniture and fixtures	**111**	**88**	111	78
Computers and computer software	**121**	**110**	106	101
	618,494	**183,566**	496,126	109,970
Net book value		**434,928**		386,156

7. Contracts

Contracts consist of the following:

In thousands of dollars	**2006**		2005	
	Cost	**Accumulated amortization**	Cost	Accumulated amortization
Contracts	**159,932**	**17,203**	23,748	5,671
Net book value		**142,729**		18,077

For the year ended December 31, 2006, the net book value of contracts is being shown separately on the balance sheet; previously this was included as part of property, plant and equipment. The net book value relates to the fair value of the power purchase agreements, natural gas purchase agreements and steam sales agreements of the operating entities when they were acquired by the Fund, net of amortization. The comparative figures, including the amortization of the contracts, have been reclassified in order to conform to this presentation. See notes 8 and 11 for details on additions to contracts during 2006.

8. Investment in German Wind Farms

On April 25, 2006, the Fund completed the acquisition of two operating wind farms in Germany with a total capacity of 21.5 MW for $0.2 million, including transaction costs. The 7.2 MW Kavelstorf wind farm is located in northern Germany near Rostock and has six Nordex wind turbines. The 14.3 MW Eckolstädt farm has 11 wind turbines supplied by Bonus Energy A/S (a member of the Siemens AG group) and is located near Weimar in central Germany. The consideration paid by the Fund has been allocated to net assets acquired as follows:

In thousands of dollars	
Working capital	190
Property, plant and equipment	20,248
Contracts	2,690
Future taxes	(294)
Debt	(18,978)
Other long-term liabilities	(3,688)
Total purchase price	168
Less: cash acquired	(143)
Total cash purchase price	25

On the same date, a subsidiary of the Fund purchased receivables owing to the vendors for $3.9 million. Subsequent to the acquisition, the Fund advanced a €14 million loan to a European subsidiary, which was used to repay all third-party debt owed by the German wind facilities in the amount of $19.0 million.

The acquisition of the two German wind farms and the receivables owing to the vendors, along with repayment of the third-party debt, was funded by internal cash and $5 million of the Fund's acquisition line. As part of the transaction, the Manager earned a one-time fee of $0.3 million, which is included in the Fund's consolidated statement of income and deficit, and will earn an annual management fee of €75,000.

During the year, the Fund entered into foreign exchange contracts with respect to the Fund's net investment in the German wind farms. As at December 31, 2006, the Fund had the following foreign exchange forward contracts in place to establish rates of exchange for the following amounts:

- Forward contracts to sell €1 million semi-annually from April 2007 to April 2011 at $1.4334:€1; and
- A forward contract to sell €10 million April 2011 at $1.4536:€1.

Of these contracts at December 31, 2006, $23.3 million was designated as a hedge of the net investment for accounting purposes, while the remaining $5.9 million was not designated as part of a hedging relationship for accounting purposes. The fair value of the contracts at December 31, 2006, was an unrealized loss of $1.6 million. The change in fair value of these contracts that are designated as a hedge since inception was an unrealized loss of $1.2 million, all of which has been included in the cumulative translation adjustment on the consolidated balance sheet. The amount of the change in fair value related to the contracts that are not designated as a hedge was an unrealized loss of $0.4 million, which is included in the consolidated financial statements of the Fund.

9. Investment in Mont Miller

On August 5, 2004, the Fund committed to invest $95 million in a 54 MW wind power project to be constructed in the Gaspésie region of Quebec by Mount Miller Wind Energy Limited Partnership ("Miller LP"). Construction of the project commenced in August 2004 with commercial operations beginning on June 9, 2005. The Fund owns all of the Class A Priority Units in Miller LP. The Class A Priority Units are entitled to a priority annual cumulative distribution of $5.8 million. After payment of that amount, distributions are shared equally between the holders of the Class A Priority Units and the Class B Subordinated Units, which are owned by the developer of the project, Mount Miller Construction and Services Inc. ("Miller Construction"), a 50%-owned subsidiary of Northland Power Inc., the parent of the Manager.

Acquisition and construction of the project were financed using the majority of the proceeds of the offering of convertible unsecured subordinated debentures (see note 16) and a $40 million non-recourse construction and term loan financing with a major Canadian financial institution (see note 13).

10. Investments in Panda Energy Corporation

In December 2003 when the Fund acquired a 19% equity interest in PEC and extended the senior loan receivable of US$93 million, PEC, through its wholly owned subsidiaries, owned two combined-cycle cogeneration power facilities that use natural gas as their primary fuel: the 230 MW Panda-Brandywine facility, located just outside Washington, D.C., and the 180 MW Panda-Rosemary facility, located in Roanoke Rapids, North Carolina. The Panda-Rosemary facility was sold on February 8, 2005, under the terms of an agreement that was executed in November 2004, and Panda-Rosemary LP was wound up shortly thereafter. At the closing of the sale on February 8, 2005, the Fund received US$18.9 million (CA$23.5 million) as partial repayment of the senior loan and payment of fees and dividends totalling US$4.8 million (CA$6.0 million). The interest rate on the balance of the Fund's senior loan receivable was increased by 0.4% to 10.9% for the remainder of the term.

As at December 31, 2006, the senior loan receivable was due as follows:

In thousands of U.S. dollars	
Due within one year	2,344
Long-term receivable	67,805
Total receivable	70,149

As at December 31, 2006, the Fund had outstanding a foreign exchange contract to sell US$900,000 in February 2007 at $1.22 in respect of the next interest and principal payment to be received on the senior loan receivable, as well as US$750,000 per quarter to November 2009 at 1.1361. The amount of change in fair value of these contracts at December 31, 2006, was not significant.

11. Investment in Kingston CoGen Limited Partnership

KCLP Acquisition

On March 23, 2006, the Fund acquired the 50% interest in KCLP that it did not already own for $127.9 million plus $0.5 million in transaction costs. The acquisition of KCLP has been accounted for using the step-by-step purchase method. On March 23, 2006, the Fund issued 11,560,000 subscription receipts at $15.15 each for net proceeds of $165.8 million primarily to fund the acquisition. The consideration paid by the Fund has been allocated to net assets acquired as follows:

In thousands of dollars	
Working capital	16,579
Property, plant and equipment	52,422
Contracts	133,494
Debt	(65,108)
Other long-term liabilities	(8,959)
Total purchase price	128,428
Less: cash acquired	(10,630)
Total cash purchase price	117,798

Other long-term liabilities consist of $0.4 million of unearned discounts and deferred credits related to the long-term contractual services agreement KCLP has with General Electric for its gas turbine and $8.6 million related to 50% of the fair market value of the interest rate swaps KCLP entered into with two commercial banks that effectively fix the interest rate of the KCLP credit facility over the life of the power purchase agreement (see note 14).

As part of the transaction, the Manager earned a one-time fee of $2.0 million, which is included in the Fund's consolidated statement of income and deficit, and will earn an incremental management fee of $0.3 million per annum.

Subsequent to the acquisition of the remaining 50% of KCLP, the $33.5 million that KCLP owed to OEFC through its levelization account was repaid.

KCLP Debt

The figures in the following table represent the Fund's 100% share (2005 – 50%) of KCLP's debt under its credit agreement ("the KCLP Credit Agreement") and certain cash advances from OEFC ("levelization account") as at December 31:

In thousands of dollars except as indicated	**2006 (100%)**	2005 (50%)
Term loan	**68,041**	37,648
Senior secured note	**25,000**	12,500
Levelization account	**–**	16,600
	93,041	66,748
Less: current portion	**8,008**	4,488
	85,033	62,260

All 2005 comparative figures shown below have been restated to 100% of KCLP's 2005 balances for comparison purposes.

The KCLP Credit Agreement includes a $9,226,000 letter of credit facility under which $9,226,000 (2005 – $9,226,000) was utilized at December 31, 2006. Payments on the term loan facility are made semi-annually until March 31, 2013, and payments on the senior secured notes will be made semi-annually beginning September 30, 2013, and ending September 30, 2016.

The term loan bears interest, paid quarterly, at the prevailing prime lending rate plus 0.50% or the 90-day banker's acceptance rate plus 1.25%. The note bears interest, paid quarterly, at the prevailing prime lending rate plus 1.25% or the 90-day banker's acceptance rate plus 2.0%.

KCLP entered into interest rate swap agreements with two commercial banks that effectively fix the interest rate of the KCLP Credit Agreement over the life of the agreement. The notional amount of the interest rate swaps totalled $93,041,000 at December 31, 2006 (2005 – $100,295,000), with an effective interest rate of 7.98% (2005 – 7.97%), and the fair value was approximately $15,356,000 unfavourable (2005 – $18,939,000 unfavourable).

The KCLP Credit Agreement financing is principally collateralized by a first priority lien and security interest in all assets of KCLP and a pledge of the partners' KCLP partnership interests.

Principal repayments over the next five years and thereafter are as follows:

In thousands of dollars	
2007	8,008
2008	8,539
2009	9,082
2010	10,556
2011	11,735
>2011	45,121
	93,041

KCLP's cash reserves for major maintenance costs are stipulated under KCLP's Credit Agreement.

12. Bank Credit Facility

The Fund and its subsidiary, Iroquois Falls Power Corp. (IFPC), have a credit agreement with Canadian Imperial Bank of Commerce as agent for a syndicate of banks that establishes the following: an $87,500,000 line of credit to assist in the funding of expansionary capital expenditures, acquisitions and investments by the Fund; a $7,500,000 revolving-term letter of credit facility to be used in meeting obligations under IFPC's natural gas transportation and supply contracts; and up to $10,000,000 of the line of credit can be used as a revolving-term operating line of credit for IFPC's general corporate purposes. The credit agreement expires on May 20, 2007, but is subject to an annual renewal at the discretion of the Fund. As at December 31, 2006, the variable interest per annum under each of the components of the credit facility is charged at 6.0%, 5.7% or 6.3%, depending on the currency borrowed. Standby fees of 0.2% per annum are charged on each of the undrawn credit facilities.

As at December 31, 2006, a letter of credit for $7,460,000 (2005 – $7,460,000) was outstanding under the letter of credit facility. As at December 31, 2006, $5,000,000 (2005 – nil) had been drawn on the acquisition line of credit and no drawings had been made on the operating line (2005 – nil).

Amounts drawn under the credit agreement are principally collateralized by a debenture security and by general security agreements that 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.

13. Mont Miller Term Loan

On October 8, 2004, Miller LP entered into a credit agreement with The Manufacturers Life Insurance Company for a $40 million construction and term loan. The agreement called for funding during the construction of the Mont Miller wind farm and then conversion to a term loan on substantial completion of the construction and commencement of commercial operations. On September 20, 2005, the $40 million construction loan was converted into a term loan with interest at 6.5%. The loan agreement required payment of interest only until December 31, 2005, and thereafter quarterly payments of principal and interest are payable until maturity on December 31, 2025. The quarterly principal payments are made in accordance with a schedule designed to fully amortize the loan over its term. The loan is without recourse to the Fund and the assets and undertakings of Miller LP and the partners' partnership interests are pledged as collateral against the loan. A total of $1.2 million in interest incurred during construction has been capitalized and included in the capital costs of the Mont Miller project.

Principal repayments over the next five years and thereafter are as follows:

In thousands of dollars	
2007	951
2008	1,108
2009	1,275
2010	1,264
2011	1,416
>2011	33,178
	39,192

14. Other Long-Term Liabilities

Other long-term liabilities consist of the following:

In thousands of dollars	**2006**	2005
KCLP obligations related to GE agreement	**1,342**	331
Fair market value of 50% of KCLP interest rate swaps	**8,373**	–
	9,715	331

KCLP Obligations Related to GE Agreement

Late in 2004, KCLP entered into a long-term contractual services agreement (CSA) with GE for scheduled maintenance. The agreement covers new parts and various services for the gas turbine. Payments are made to GE over the length of the contract at various times and for different amounts. The payments are recorded as deferred charges on the balance sheet when they are made and then relieved from the deferred charges account and expensed over the life of the agreement on a per-fired-hour basis.

Upon the signing of the CSA, GE provided a US$2.0 million special credit that was to be applied against the first US$4.0 million of liabilities under the CSA. The special credit is charged to an unearned discounts account and is recognized over the life of the CSA as a reduction of the cost of services expensed.

For balance sheet presentation, the unearned discounts account has been netted with the deferred charges account and included in other long-term liabilities.

Fair Market Value of 50% of KCLP's Interest Rate Swaps

KCLP entered into interest rate swap agreements with two commercial banks that effectively fix the interest rate of the KCLP credit facility over the life of the agreement. Fifty per cent of the fair market value of the interest rate swaps was included as part of the net assets acquired on March 23, 2006 (see note 11) and is being amortized into income over the term of KCLP's credit facility.

15. Asset Retirement Obligation

The Mont Miller facility was constructed on land leased from the Government of Quebec for a 25-year period with an option to extend the leases for an additional 15 years. Upon the expiration of the leases, the leased land must be returned to its original condition and all turbines dismantled. The majority of the costs are expected to be incurred in approximately 40 years once the original leases and 15-year extensions have expired.

The German wind farms are constructed on lands under leases that expire in 2030. The Manager of the wind farms estimates that the net asset retirement obligation for the two German wind farms will be approximately $0.2 million at the expiration of the power purchase agreements with the German government.

The Fund has estimated the fair value of its total asset retirement obligations for all of its wind farms to be $2.9 million, based on a total future liability of $28.6 million. The Fund's credit-adjusted discount rate of 6.15% and an inflation rate of 2.50% were used to calculate the fair value of the asset retirement obligations. These asset retirement obligations relate solely to the Fund's wind facilities, as the Fund expects to use its other installed assets for an indefinite period. Revisions to the Fund's asset retirement obligations will be made if new information is received.

The following table reconciles the Fund's total asset retirement obligation activity for the year ended December 31, 2006:

In thousands of dollars	
Balance at December 31, 2005	2,687
Increase related to acquisition of German wind facilities	68
Accretion expense	174
Effect of exchange rate differences	6
Balance at December 31, 2006	2,935

16. Convertible Unsecured Subordinated Debentures

On August 26, 2004, the Fund closed an offering of 65,000 6.5% convertible unsecured subordinated debentures due June 30, 2011 ("the convertible subordinated debentures") at a price of $1,000 per convertible subordinated debenture, for gross proceeds of $65 million and net proceeds of approximately $61.8 million. Interest is paid semi-annually in arrears on June 30 and December 31 in each year.

The convertible subordinated debentures are convertible into fully paid units of the Fund at the option of the holder at a conversion price of $12.50 per unit and are redeemable by the Fund on or following June 30, 2007, provided that the trading price of the Fund's units reaches certain levels. The Fund may at its option satisfy its obligation to pay the redemption price of the convertible debentures in trust units of the Fund. The Fund determined that the fair value of the embedded holder option at the time of issue was minimal, and as a result the entire amount of the convertible subordinated debentures has been classified as a liability.

The payment of convertible debenture principal and interest is subordinated in right of payment to the prior payment of all senior indebtedness of the Fund. A total of $3.2 million in costs related to the convertible debentures, including the underwriters' fee, is being deferred and amortized over the term of the convertible debentures and is included in deferred charges. A total of $3.2 million in interest incurred during construction of the Mont Miller facility has been capitalized and included in property, plant and equipment.

During 2006, a total of $16.8 million (2005 – $18.9 million) of convertible unsecured debentures have been converted into 1,342,080 (2005 – 1,515,360) trust units.

17. Trust Units

The Fund may issue an unlimited number of trust units subject to rules governing the trust indenture. 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.

The trust units are redeemable at any time on demand by the holders at their fair value, determined as the lesser of: (a) 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; or (b) 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: (a) 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; (b) 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 that

NPIF Commercial Trust trustees consider, in their sole discretion, provides representative fair market value prices for the trust units; or (c) 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 10-trading-day period commencing immediately after the date on which the trust units are tendered for redemption.

The change in trust units during 2005 and 2006 is as follows:

In thousands of dollars except for units	Number of units	Amount
Outstanding as of December 31, 2004	47,915,943	468,641
Conversion of subordinated debentures during 2005	1,515,360	18,942
Outstanding as of December 31, 2005	49,431,303	487,583
March 23, 2006, issue, net of underwriters' fee[1]	11,560,000	166,377
Cost of issue		(552)
Conversion of subordinated debentures during 2006	1,342,080	16,776
Outstanding as of December 31, 2006	62,333,383	670,184

(1) On March 23, 2006, the Fund issued 11,560,000 subscription receipts at $15.15 per subscription receipt to raise proceeds, net of the underwriters' fee of $166.4 million. In accordance with the Subscription Receipt Agreement pursuant to which the subscription receipts were issued, the gross proceeds from the offering were deposited with a subscription receipt agent to be held in escrow. On the same date the conditions to the release of the escrowed funds were satisfied and, accordingly, trust units of the Fund were issued to the holders of the subscription receipt on a one-for-one basis. The proceeds from the issue were used by the Fund primarily toward the investment in KCLP (see note 11).

The reconciliation of the denominator in calculating diluted per-unit amounts is as follows:

	2006	2005
Weighted average number of units outstanding, basic	**59,310,753**	48,551,292
Effect of dilutive securities:		
Convertible unsecured subordinated debentures	**3,084,177**	4,886,707
Weighted average number of units outstanding, diluted	**62,394,930**	53,437,999

18. Distributions to Unitholders

Distributions totalling $1.08 per trust unit (2005 – $1.05), being aggregate distributions of $64,937,000 (2005 – $51,101,000), were declared by the Manager of the Fund for the year ended December 31, 2006. For income tax purposes, $26,640,000 (2005 – $21,473,000) of the distributions is a return of capital.

19. Management Compensation

The Manager is entitled to receive a fee for services provided relating to the operation and management of the Iroquois Falls facility pursuant to a 25-year management agreement expiring in 2021. The annual fee is payable on an equal monthly basis and is adjusted annually with changes to the consumer price index. During the year ended December 31, 2006, the Manager was paid $552,000 (2005 – $539,000). The Manager is also entitled to operation-related incentive fees. During the year ended December 31, 2006, the Manager earned $983,000 (2005 – $2,456,000) as operation-related incentive fees, which are included in cost of sales. All other fees paid to the Manager are included in management and administrative costs.

Commencing in 2004, the Manager began to receive from PIC a loan administration fee of US$125,000 and a manager's fee of US$75,000 (to reimburse third-party costs) per annum, adjusted annually to reflect changes in the U.S. consumer price index. During the year, the Manager received $242,000 (2005 – $253,000) related to the PIC loan administration and manager's fee.

During the year ended December 31, 2006, the Manager was paid nil (2005 – $250,000) related to the acquisition of the interests in PEC in December 2003.

During the year ended December 31, 2006, the Manager earned a one-time fee of $2.0 million related to the acquisition of the remaining 50% interest in KCLP on March 23, 2006. After acquiring the remaining 50% interest in KCLP, the Manager became entitled to receive an annual $400,000 fee that is payable on an equal monthly basis and is adjusted annually with changes to the consumer price index for services provided relating to the operation and management of the Kingston facility, pursuant to a management agreement expiring in 2017. During the year ended December 31, 2006, the Manager was paid $300,000 (2005 – nil). This agreement and applicable fee replace the fee the Manager had been previously receiving from NPIF Commercial Trust related to the administration of the trust and its investments; during 2006, the Manager received $66,000 related to the portion of the year prior to March 23, 2006 (2005 – $62,000).

In connection with the operation of the Mont Miller wind farm, the Manager and affiliated parties of the Manager have received compensation as follows:

(a) Upon completion of the construction of the Mont Miller project, Miller Construction was entitled to a one-time special distribution on the Class B Subordinated Units equal to the amount that the actual costs of construction were less than the Fund's committed investment in the project. Accordingly, Miller Construction received a special distribution in the amount of $4,971,500 during the third quarter of 2005. This special distribution was included in the capital cost of the Mont Miller project.

(b) Upon successful commercial operation of the project, the Manager was appointed manager of the Mont Miller project and is responsible for all management functions in return for an annual fee of $300,000 escalating annually according to changes in the Canadian consumer price index. Two-thirds of the fee is subordinated to Class A Priority distributions. During 2006, the Manager received $101,000 (2005 – $56,000).

(c) Miller Construction, as the holder of Class B Subordinated Units of Miller LP, will be entitled to receive, in any year, 49.95% of the amount by which available cash flow from Miller LP exceeds $5,786,880 on an annualized basis. No amounts were paid to Miller Construction in 2006 and 2005.

During the year ended December 31, 2006, the Manager earned a one-time fee of $0.3 million related to the acquisition of the Eckolstädt and Kavelstorf wind farms on April 25, 2006. After the acquisition, the Manager became entitled to receive an annual management fee of €75,000, which is adjusted annually with changes to the consumer price index. In 2006, the Manager earned $86,000.

The Manager received a management incentive fee of $1,800,000 (2005 – nil) equal to 25% of the amount by which annual distributable cash exceeded $0.934 per unit, less the amount of certain operation-related incentive fees.

20. Income and Other Taxes

The components of income tax expense (recovery) are as follows:

In thousands of dollars	**2006**	2005
Current	**(588)**	611
Future	**(297)**	(261)
Provision for (recovery of) income taxes	**(885)**	350

The components of future income tax assets are as follows:

In thousands of dollars	**2006**	2005
Future tax assets		
Undepreciated cost of capital assets in excess of property, plant and equipment book value	**988**	775
Other	**416**	626
Net future tax assets	**1,404**	1,401
Income before income taxes	**33,264**	44,671
Combined federal and provincial income tax at statutory rate of 36.12% (2005 – 36.12%)	**12,015**	16,135
Manufacturing and processing deduction	**–**	(59)
Income of Fund distributed to Unitholders	**(20,527)**	(14,271)
Valuation allowance	**–**	(1,205)
Rate differentials	**267**	–
Large corporations tax and other items	**7,360**	(250)
Provision for income taxes	**(885)**	350

At December 31, 2006, financing expenses and underwriters' fees of $3,695,000 (2005 – $7,032,000) are deductible by the Fund and its subsidiaries for income tax purposes on a straight-line basis over five years.

There can be no assurance that the Internal Revenue Service (IRS) will not challenge various tax filing positions by the Fund and IFPC relating to the senior loan receivable from PIC, contrary to tax opinions received in December 2003, which could result in a U.S. federal income tax liability and/or withholding tax liability. Although management believes it is unlikely that the IRS would be successful, a reduction in the deductibility of the interest payment on the PIC senior loan or the application of withholding taxes could result in the Fund incurring a liability for taxes and/or a reduction of future income and cash receipts. If interest received from PIC is subject to withholding tax, management estimates that the impact on an annual basis would be approximately $1.2 million in taxes.

On October 31, 2006, the Canadian federal government announced tax proposals pertaining to taxation of distributions paid by income trusts and changes to the personal tax treatment of trust distributions that will be applicable starting in 2011. Currently, the Fund does not pay income tax as long as distributions to Unitholders exceed the amount of the Fund's income that would otherwise be taxable. The proposed new law will result in a two-tiered tax structure similar to that of corporations whereby the taxable portion of distributions would be subject to income tax payable by the Fund at a rate of 31.5%, while taxable Canadian Unitholders would receive the favourable tax treatment on distributions currently applicable to qualifying dividends. As of the date of these financial statements, the government's proposal remains draft and has not been passed into law.

In addition to the foregoing, the Fund is subject to various additional uncertainties concerning the interpretation and application of Canadian and U.S. tax laws that could affect the Fund's profitability and cash flows.

21. Commitments

IFPC and KCLP have entered into agreements for the supply of natural gas for various terms to 2017. These agreements were entered into in the normal course of business to purchase natural gas for electricity production and steam generation on terms that would protect the profitability of sales under the long-term electricity sales contracts with OEFC and the steam sales agreements. There are no penalties for failure to purchase natural gas under these contracts; however, failure to purchase the specified minimum quantities could reduce the suppliers' delivery obligations.

IFPC and KCLP have entered into agreements for gas transportation that incorporate standard industry terms including the approval of tariffs by applicable regulatory authorities. The natural gas transportation agreements include substantial demand charges, which are incurred whether or not gas is shipped.

Substantially all of the cost of sales, with the exception of certain incentive fees paid to the Manager, relate to the purchase and transportation of natural gas under these contracts.

In the ordinary course of business, KCLP entered into an agreement with GE Canada and GE Energy Parts, Inc. that provides new parts and repair services for scheduled maintenance. The total commitment over the remaining life of the contract is approximately US$13 million. The agreement expires after 68,000 hours of operation, which is estimated to be in 2016.

Upon the commencement of successful commercial operations of the Mont Miller facility on June 9, 2005, a five-year warranty, maintenance and services agreement with Vestas-Canadian Wind Technology Inc. came into effect. The fixed contractual obligations over the remaining life of the agreement are approximately $3.2 million.

On October 16, 2006, the Fund announced that it will provide a $35 million loan, subordinated to the senior project debt, for the Thorold Cogeneration Project being developed by an entity owned by Northland Power Inc. (the parent of the Fund's Manager). The loan is repayable over five years from completion of the project and has an effective annual interest rate of 12.5%; the Fund expects to finance the loan under its existing line of credit. The transaction is expected to close in early 2007, subject to a number of conditions including closing of the non-recourse senior secured debt financing for the project and completion of documentation.

22. Segmented Information

The Fund indirectly owns interests in two cogeneration facilities located in Ontario, a wind farm in Quebec and two wind farms in Germany. It also has a 19% equity interest in PEC and a senior loan to PIC, which are included with the Fund's corporate operating income for reporting purposes. These assets represent the Fund's reportable segments at December 31, 2006.

The Fund analyzes the performance of its operating segments based on operating income. Income for each segment is measured on the same basis as that of the Fund. Significant information for each segment is as follows:

In thousands of dollars **2006[1]**	**Iroquois Falls**	**Kingston**	**Mont Miller**	**Germany**	**Corporate**	**Total**
Sales	**74,711**	**77,973**	**9,050**	**3,057**	**–**	**164,791**
Amortization of property, plant and equipment	**8,890**	**10,281**	**4,230**	**1,954**	**–**	**25,355**
Operating income	**24,201**	**28,158**	**2,372**	**(122)**	**3,675**	**58,284**
Interest expense, net	**49**	**7,728**	**2,536**	**72**	**2,475**	**12,860**
Property, plant and equipment, net	**184,632**	**144,723**	**85,975**	**19,598**	**–**	**434,928**
Contracts, net	**8,338**	**127,838**	**4,007**	**2,546**	**–**	**142,729**
Senior loan and investment in PEC	**–**	**–**	**–**	**–**	**89,698**	**89,698**

In thousands of dollars 2005	Iroquois Falls	Kingston	Mont Miller	Germany	Corporate	Total
Sales	79,266	43,338	5,574	–	–	128,178
Amortization of property, plant and equipment	8,884	5,828	2,385	–	–	17,097
Operating income	30,910	14,310	1,796	–	12,224	59,240
Interest expense, net	49	5,978	1,445	–	2,508	9,980
Property, plant and equipment, net	193,430	102,521	90,205	–	–	386,156
Contracts, net	8,884	4,979	4,214	–	–	18,077
Senior loan and investment in PEC	–	–	–	–	92,197	92,197

(1) See note 11 regarding an additional 50% investment in KCLP on March 23, 2006.

Corporate operating income includes $11.1 million (2005 – $15.0 million) of interest and dividends from the senior loan receivable and investment in PEC.

Information on operations by geographic area is as follows:

Sales	**2006**	2005
Canada	**161,734**	128,178
Germany	**3,057**	–
Total sales	**164,791**	128,178

Property, plant and equipment, net	**2006**	2005
Canada	**415,330**	386,156
Germany	**19,598**	–
Total property, plant and equipment, net	**434,928**	386,156

As at December 31, 2006, all of the Fund's assets and sales were located in Canada and Germany with the exception of the investments in, and income from, PEC and PIC, which relate to entities in the United States.

23. Litigation, Claims and Contingencies

On December 20, 2005, Calpine Corporation, the indirect parent company of Calpine Canada Natural Gas Partnership ("Calpine"), filed for bankruptcy protection in the United States, and subsequently it was announced that Calpine was a party to insolvency proceedings in Canada. Calpine ceased supplying natural gas to IFPC's Iroquois Falls facility in January 2006. The Calpine supply was subject to a backstop arrangement under another of IFPC's gas supply contracts that provided for replacement of a significant portion of the Calpine volume in the event of default. On November 1, 2006, a settlement was finalized concerning the delivery of natural gas under the backstop provision. As part of the settlement, IFPC and the supplier have agreed to certain changes to the contractual backstop provisions. The supplier has also agreed to withdraw an unrelated claim for approximately $7.6 million plus interest. The claim had concerned the price paid for deliveries of natural gas in excess of the supplier's contractual obligations to IFPC during the period November 1998 to April 2002.

24. Comparative Figures

Certain amounts in the comparative financial statements have been reclassified from statements previously presented to conform to the presentation of the 2006 consolidated financial statements.

Corporate Information

Trustees and Officers of NPIF Commercial Trust

James C. Temerty
Chairman and Trustee
Chairman, Northland Power Income Fund Management Inc. and Northland Power Inc.

John W. Brace
President, CEO and COO
President and CEO, Northland Power Income Fund Management Inc. and Northland Power Inc.

Anthony F. Anderson
Chief Financial Officer
Chief Financial Officer, Northland Power Income Fund Management Inc. and Northland Power Inc.

Linda L. Bertoldi
Secretary
Partner, Borden Ladner Gervais LLP

Pierre R. Gloutney **
Independent Trustee
Chairman and CEO
MAN Financial Canada Co.

A. Warren Moysey * ††
Independent Trustee
Director and Chairman
Aviva Canada Inc.

F. David Rounthwaite ** ††
Independent Trustee
Principal, Nereus Financial Inc.

The Right Honourable John N. Turner, Q.C. ** †
Lead Independent Trustee
Partner, Miller Thomson LLP

* Chair of the Audit Committee
** Member of the Audit Committee of NPIF Commercial Trust
† Chair of the Governance and Nominating Committee
†† Member of the Governance and Nominating Committee

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Website: **NPIFund.com**, for supplemental information about the Fund and its businesses, as well as the latest quarterly financial information and press releases

Unitholder Information

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Toronto, Ontario, Canada

Auditors
Ernst & Young LLP
Toronto, Ontario, Canada

Registrar and Transfer Agent
Attention: Equity Services
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Toronto, Ontario, Canada
M5J 2Y1

Trust Units and Debentures
The trust units and convertible subordinated debentures are listed on the Toronto Stock Exchange and trade under the symbols NPI.UN and NPI.DB.

Annual Meeting Date and Place
Friday, May 11, 2007, at 11:00 a.m. in the TSX Conference Centre, located at The Exchange Tower, 130 King Street West (corner of King & York streets), Toronto, Ontario, Canada

Stability Ratings
Standard & Poor's has assigned the Fund a stability rating of SR-2, which denotes a very high level of stability in distributions, and a "moderate" Distribution Profile Assessment.

Distribution Reinvestment Plan
The Distribution Reinvestment Plan allows Unitholders who are residents of Canada to automatically purchase additional trust units from cash distributions received each month. Participants do not pay any costs associated with this plan, including brokerage commissions. For further information or to join the plan, contact your financial adviser or broker.

Tax Consideration
The Fund's trust units and convertible debentures are qualified investments for RRSPs and DPSPs under the Canadian Income Tax Act.

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Management Inc.

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