



Fitch Affirms Chelan County PUD (WA) Consolidated Sys Revs at 'AA+'; Outlook

Revised to Stable Ratings Endorsement Policy

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Fitch Ratings-New York-08 October 2013: Fitch Ratings has affirmed the following ratings for Chelan County Public Utility District No. 1 (the district), WA at 'AA+':

- \$25.43 million senior consolidated system revenue/refunding bonds;
- \$483.64 million subordinate consolidated system revenue/refunding bonds;
- \$28.97 million third-lien consolidated system notes;
- \$252.32 million Rock Island Hydroelectric project revenue bonds (separately secured by project revenues only);
- \$15.89 million Rocky Reach Hydroelectric project revenue bonds (separately secured by project revenues only).

The Rating Outlook is Stable.

SECURITY

The consolidated system revenue/refunding bonds are secured by a net revenue pledge of the consolidated systems, which includes the electric distribution, water, wastewater and fiber optics systems, and the Lake Chelan hydroelectric project. The senior lien is closed, and the subordinate lien is currently the operating lien.

The Rock Island and Rocky Reach project-specific bonds are secured by a separate net revenue pledge for each project.

Fitch rates all obligations the same at 'AA+' despite the tiered liens. While the distribution system and the hydro-generating projects are accounted for and can be financed separately, they are managed and operated as an integrated system with the same management team and loans flowing between the systems.

KEY RATING DRIVERS

LOW-COST POWER PROVIDER: The strong rating of the district reflects its exceptionally low-cost power resource assets, which result in extremely competitive retail and wholesale rates. Production costs are well below the regional average and are projected to remain low for the foreseeable future.

OUTLOOK REVISED TO STABLE: The Outlook revision to Stable reflects management's proactive approach to stabilizing financial metrics and minimizing hydrological risk. This includes new long-term power sales agreements with cost adders for project debt reduction and an updated physical hedging plan that allows net secondary power sales via an auction process that provides ample margins.

IMPROVED FINANCIAL PERFORMANCE: Consolidated financial metrics improved considerably in 2012 and outperformed projections, given the district's favorable changes to its wholesale power sales contracts, increased share of output from its hydro assets and profitable wholesale auction results.

AMPLE LIQUIDITY: The district maintains robust unrestricted cash reserves and funds on a consolidated basis. The district plans to use available funds for its capital program going forward. However, unrestricted balances are projected to remain more than sufficient for the rating category.

DEBT REDUCTION PLAN: Consolidated system leverage, while still somewhat high as measured by debt-to-funds available for debt service (FADS) of 5.1x, was reduced considerably at fiscal year-end 2012 (8.0x at fiscal year-end 2011). The district has implemented a debt reduction plan and outstanding debt is projected to decline further.

STRONG MANAGEMENT TEAM: The current management team has an extensive depth and breadth of industry

knowledge, along with a proven ability to achieve or outperform financial targets.

RATING SENSITIVITIES

MANAGEMENT OF REVENUE STREAMS: Given the district's reliance on asset performance and variable wholesale sales through an auction process, it is important that these sales and overall operations are managed together with retail electric rates in a way that maintains stable financial performance.

CREDIT PROFILE

RETAIL AND WHOLESALE OPERATIONS

The district is an integrated electricity provider, operating since 1947. The current retail customer base encompasses 48,463 users in central Washington. The district's electric utility operations consist of its retail distribution system (the distribution system) and its hydroelectric projects, which are Rock Island (629 megawatt [MW] generating capacity), Rocky Reach (1,300 MW) and Lake Chelan (59 MW). The distribution system includes the district's retail electric system, along with a small water and wastewater utility (1.6% of 2012 consolidated revenues), a fiber optics system (2.1% of consolidated revenues) and the Lake Chelan Hydroelectric Project.

EXTREMELY LOW-COST POWER RESOURCES

The distribution system's power requirements are met through its share of the combined output of the three hydroelectric projects, along with market purchases to smooth load. The distribution system's native load accounts for approximately 17% of the combined projects' output. The remainder is sold through long-term contracts (53%) and short- to medium-term block and slice contracts (30%). The long-term contracts extend to 2028 and 2031, prior to final debt maturity of 2042.

Rocky Reach and Rock Island are stand-alone hydroelectric generation projects that are each accounted for separately. Rocky Reach is composed of 11 separate generating units, while Rock Island has 19. Operations of the projects have been solid since inception, with plant availability factors near or above 90% for the past five years.

Four of the 11 generating units at the Rocky Reach project were recently taken offline for repairs. Cost of repairs and estimated loss of revenue from the outage is minimal and Fitch does not view the event as a credit concern.

MANAGEMENT OF POWER SUPPLY

Historically Rocky Reach and Rock Island each had individual power sales agreements, which expired on Oct. 31, 2011 and June 7, 2012, respectively. New power sales contracts went into effect in full form in 2012. Fitch views the new contracts positively, as they favorably charge on a 'cost-plus' basis, versus the previous cost of service, and include adders for capex and debt financing costs. The contracts additionally afford the distribution system a slice of the combined output of Rocky Reach and Rock Island, which equates to approximately 200 aMW of additional energy.

The district updated its power supply management plan in 2010, in order to better manage its increased amount of long capacity. Fitch views the district's current strategy as a credit strength, as it materially reduces the district's exposure to price and hydrological risks. The district uses an auction process to lock in medium-term slice contracts and short-term block contracts for approximately 27% of hydro generation output. In any given prompt year, only approximately 3% of the district's generation capacity is exposed to current market conditions.

FINANCIAL PERFORMANCE

Financial results strengthened considerably in 2012, due to above-average water conditions in 2011 and 2012, coupled with various cost-cutting initiatives and favorable changes to power supply strategies. Fitch-calculated debt service coverage increased to 2.36x in 2012, the highest coverage the district has seen over the past 10 years. This level is in line with the 'AA+' rating category medians. Financial results for 2012 outperformed previous projections, with higher coverage levels and lower leverage, due to a paydown of outstanding debt.

Current projections are stronger than ones previously submitted and show coverage staying above 2.0x through 2018, with the exception of 2014 due to increased debt paydown. Debt-to-FADS is projected to decrease significantly, from 5.1x in 2012 down to 3.9x in 2018.

The district maintains ample liquidity, which Fitch views as an essential credit strength supporting the 'AA+' rating.

Unrestricted funds at fiscal year-end 2012 totaled \$239 million, equivalent to 564 days cash on hand, not including funds held at the project level. If unrestricted project funds were included, DCOH would increase to 621 days.

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In addition to the sources of information identified in Fitch's Revenue-Supported Rating Criteria, this action was additionally informed by information from Creditscope.

Applicable Criteria and Related Research:

--'U.S. Public Power Peer Study -- June 2013' (June 13, 2013);
--'U.S. Public Power Peer Study Addendum -- June 2013' (June 13, 2013);
--'U.S. Public Power Rating Criteria' (Dec. 18, 2012).

Applicable Criteria and Related Research:

U.S. Public Power Rating Criteria
U.S. Public Power Peer Study -- June 2013
U.S. Public Power Peer Study Addendum

Additional Disclosure

Solicitation Status

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