

October 25, 2011

### Summary:

## Chelan County Public Utility District No. 1, Washington; Retail Electric; Wholesale Electric

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Credit Profile		
US\$164.425 mil cons sys rfdg bnds (taxable) ser 2011C due 07/01/2026		
<i>Long Term Rating</i>	AA/Stable	New
Chelan County Public Utility District #1 con sys		
<i>Long Term Rating</i>	AA/Stable	Affirmed
Chelan Cnty Pub Util Dist #1 Hydro-Electric sys rev bnds ((Non-Amt)) ser 2009A		
<i>Long Term Rating</i>	AA/Stable	Affirmed
<b>Chelan Cnty Pub Util Dist #1 (Chelan Hydroelec Cons Sys) cons sys rev</b>		
<i>Unenhanced Rating</i>	AA(SPUR)/Stable	Affirmed

## Rationale

Standard & Poor's Ratings Services has assigned its 'AA' long-term to Chelan County Public Utility District No. 1, Wash.'s proposed consolidated system revenue bonds series 2011C. At the same time, Standard & Poor's affirmed its 'AA' rating on Chelan's consolidated system revenue obligations, both senior and subordinate lien. The outlook is stable.

The district's net revenue pledge secures the 2011C bonds.

The affirmation reflects our view of the district's strong business risk profile in its consolidated system, which includes its electric, water, and wastewater utility; telecommunications unit; and the Lake Chelan hydroelectric project.

In our opinion, key strengths include:

- Chelan's extremely low rates, which are among the lowest in the country. at about one-fourth of the national average;
- Very low operating costs, which arise from strong hydroelectric generating assets; and
- Very strong cash position, with more than one year's expenditures held in cash, historically and projected.

We believe offsetting factors include exposure to variable hydrology, which can affect net wholesale revenues, as happened in 2009 and 2010. The consolidated system is the ultimate obligor for the district's utility systems and hydroelectric projects issuing debt through the consolidated system's bond resolution. The resolution that created the operating lien effectively closed what had been the senior lien. In addition, under the subordinate operating lien resolution, bond protections have improved slightly. Consequently, Standard & Poor's does not distinguish between the two liens. The 2011C bonds will refinance up to \$164 million in senior bonds issued from 2002-2004.

Supporting Chelan's strong business profile ('3' on Standard & Poor's scale of '1' to '10', with '1' as the strongest) are the district's rate-setting ability, extremely low-cost power supply, moderate asset and resource concentration,

and a low degree of merchant risk-related nonfirm surplus sales. Its low-cost power supply comes from its three hydroelectric plants, which produced power at an average \$21 per megawatt (MW)-hour in 2010. Chelan officials project the utility will maintain its competitive advantage in the region, assuming average hydrological conditions. Furthermore, given its resources in comparison to its native load demand, the district has surplus power under almost all hydrological conditions. Profits from surplus power sales contribute to Chelan's very low retail rates.

The district sells far more power to contractual offtakers and the wholesale market than to its own retail system. Its distribution system takes about a third of the total output from its Lake Chelan, Rocky Reach, and Rock Island projects and sells the remainder to other utilities in the region through long-term, take-or-pay contracts that expire in 2011 and 2012. The distribution system has surplus capacity in nearly all months, even under very low water conditions. The amount of surplus available to Chelan will increase about 200 MW after the contracts expire. Management plans to sell a portion of the surplus in multiyear blocks, annually and on a rolling basis. We believe this strategy will reduce the negative impacts of low stream flows.

Debt service coverage (DSC) ratios at the consolidated system were about 1.25x in fiscal years 2009 and 2010, down from 1.60x in 2008, due mainly to declines in off-system sales revenue. DSC at the consolidated level is sensitive to wholesale sales not under long-term contracts. In fiscal years 2009 and 2010, below-average stream flows and low market power prices lead to the lower DSC levels. Ordinarily, low stream flows are inversely correlated to market prices, which support greater stability in Chelan's wholesale revenues. In response to fiscal challenges related to a decline in wholesale revenues that began in 2009, the district's board approved a 9% surcharge on its retail rates that will remain in effect through Dec. 31, 2011. Offset by a 2.5% base rate increase, the surcharge's end will result in retail rates falling 6.5% beginning in fiscal 2012. The surcharge is in conjunction with other budget measures that management has implemented, including deferring some capital expenditures, unpaid furloughs and wage increase give-backs for executives, and a hiring freeze. In our view, management's responsiveness, combined with its very strong cash reserves, offset declines in wholesale sales revenues. In addition, due to the terms of its power sale contracts that will take effect in 2011 and 2012, and the increased share available for market sales benefitting the consolidated system, we expect that Chelan will increase net wholesale revenues 2012. We view the onset of the new contractual framework as positive.

The district's capital improvement plan for 2012-2016 averages \$53 million in annual spending, with projects across its distribution, generation and fiber optic systems. At this time, management expects to fund the plan from available funds, without issuing additional debt. Chelan's capital plan does not include new money debt during the next five years. Furthermore, management expects to reduce debt up to \$200 million through a combination of scheduled maturities and cash defeasances.

## Outlook

The stable outlook reflects our assessment of Chelan's strong financial policies regarding DSC and liquidity, as well as its low cost power supply. The outlook also reflects our expectation that management will continue to enact budget measures to counter any revenue shortfalls that would occur in its wholesale operations, to achieve targeted liquidity levels.

## Related Criteria And Research

USPF Criteria: Electric Utility Ratings, June 15, 2007

<b>Ratings Detail</b> (As Of October 25, 2011)		
Chelan Cnty Pub Util Dist #1 (Chelan Hydroelec Cons Sys) jr lien		
<i>Long Term Rating</i>	AA/Stable	Affirmed
Chelan County Public Utility District #1 cons sys ser 2008B		
<i>Long Term Rating</i>	AA/A-1+/Stable	Affirmed
<b>Chelan Cnty Pub Util Dist #1 cons sys rev</b>		
<i>Unenhanced Rating</i>	AA(SPUR)/Stable	Affirmed
<b>Chelan Cnty Pub Util Dist #1 (Chelan Hydroelec Cons Sys) cons sys rev</b>		
<i>Unenhanced Rating</i>	AA(SPUR)/Stable	Affirmed

Many issues are enhanced by bond insurance.

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