FITCH AFFIRMS CHELAN PUD'S (WA) $200.3MM CONSOLIDATED SYS REV BONDS AT 'AA+'; OUTLOOK TO NEGATIVE

Fitch Ratings-New York-27 April 2011: Fitch Ratings has assigned an 'AA+' rating to Chelan County Public Utility District No. 1's (PUD, or the district) $122.3 million and $78 million in consolidated system revenue bonds (subordinate lien), refunding series 2011A and 2011B, respectively.

The series 2011A and B bonds, scheduled to price May 18, 2011, will be issued as fixed rate bonds to economically refund certain existing senior consolidated system revenue bonds. The final maturity on the 2011 bonds is 2026, which is shorter by approximately 10 years compared to existing bonds to be refunded.

Fitch also affirms the 'AA+' rating on the following outstanding bonds issued by the district or by its wholly owned hydroelectric generating stations (Rocky Reach and Rock Island projects):

--$445.4 million senior consolidated system revenue/refunding bonds;
--$201.7 million subordinate consolidated system revenue/refunding (on parity with proposed 2011A and B bonds);.
--$82.7 million third lien consolidated system notes (due 2013-2014);
--$278.7 million, Rock Island Hydroelectric project revenue bonds (separately secured by project revenues only);
--$21.1 million, Rocky Reach Hydroelectric project revenue bonds (separately secured by project revenues only).

The Rating Outlook on all bonds is revised to Negative from Stable reflecting the distribution system's fiscal challenge of managing considerable surplus sales for resale during this period of economic slowdown coupled with depressed wholesale electricity prices and below-average water conditions through 2010. Additionally, ongoing net losses at the fiber optics system continue to require subsidization from the distribution division.

SECURITY:
For Rock Island and Rocky Reach project-specific bonds, the bonds are secured by a separate net revenue pledge for each project. For the consolidated system revenue/refunding bonds, the 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 the operating lien.

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

RATING RATIONALE
--Chelan County PUD's strong credit rating reflects its very low cost hydroelectric power resources, with a blended average production cost of 2.1 cents per kilowatt hour (kwh) for 2010.
--At the distribution system level, the district's average electric retail rates are among the lowest in the country at 3.4 cents per kwh delivered in 2010.
--On an aggregate system basis (including all systems and the hydro projects) the district maintains very solid cash reserves (499 days operating cash for fiscal year end [FYE] 2010).
--However, aggregate financial performance has been more variable. Debt service coverage for all debt obligations has ranged from a 1.83 times (x) (FY2007) down to 1.24x (FY2010).
--The revenue volatility exists predominantly at the distribution and fiber optics systems. The fiber

optics system has been operating at a net loss (-$7 million for FYE 2010) since commencing operations, and the distribution system relies to a large degree (35% of system revenues) upon margins from non-firm surplus hydropower sales.
--Surplus sales for resale are subject to greater volatility primarily due to fluctuating wholesale electricity market prices and hydrological conditions, both of which have been at considerably low levels for the past three years.
--Positively, the district has embarked on a debt reduction plan, and with no new debt financings projected through 2015 (it will internally fund 100% of capital expenditures), all-in debt burden will decline by at least 16.5% (or $171 million scheduled principal payments) to less than 60% debt ratio by 2015.
--Additionally, with new intermediate-term (three to four year duration) and long-term (20-year) power sales contracts scheduled to take effect in 2011/2012, the vast majority (more than 90%) of the hydropower output will be sold pursuant to contracted sales.
--Moreover, the contracted sales for resale are based upon more favorable rates and terms for the district than existing agreements, which should result in greater revenue stability beginning in FYE 2012.
--The district also benefits from owning environmentally 'green' hydroelectric assets (non-carbon emitting) and is well positioned in regard to the state's renewable energy goals.

KEY RATING DRIVERS:
--Regional hydrological conditions and wholesale electricity market prices remain key rating drivers for the district.
--Continued Board willingness to adjust retail rates to maintain adequate liquidity and financial protection measures at the distribution division.
--Maintenance of the 'AA+' rating for all systems depends upon the district achieving projected financial performance measures commensurate with the rating category by FYE 2012 (including 2.0x debt service coverage for all debt obligations). Material deviation from the financial projections may result in negative rating action.

CREDIT SUMMARY:
Chelan County PUD No.1 is an integrated electricity provider, providing electric service since 1947. The current retail customer base encompasses 48,124 users in central Washington. The retail distribution system is part of the district's 'consolidated system', which also includes a small water/wastewater utility (5,448 users/479 users), a fiber optics system (10,700 end users) and the Lake Chelan Hydroelectric Project (59 megawatt {MW] generating capability). These systems operate as one system for financing purposes.

The district also owns two large hydroelectric generating projects - Rock Island and Rocky Reach facilities. Chelan's retail distribution division currently meets most of its power supply from its share of the combined output of its three hydroelectric facilities (1,988 MW in total). The average cost of hydro production from these facilities is very competitive at 2.1 cents/kwh for the year ended Dec. 31, 2010. In comparison, Bonneville Power Administration, a large federal power provider in the region and the Mid-C (Columbia) wholesale electricity market price averaged closer to $33/mwh for the same period.

A large portion (67.4%) of the hydropower is currently sold off-system pursuant to long-term contractual sales through 2011/2012, but a considerable portion remains in shorter term wholesale market sales (14.2% of total kwh sales for FY 2010). These non-firm market sales accounted for a significant 35% of distribution system revenues in FY 2010.

Wholesale market sales by their nature are more volatile given variability in hydropower availability and movements in wholesale electricity market prices. This revenue variability has been a key focus of management and the governing board discussions for the past five years. The district has developed a comprehensive strategy to minimize wholesale revenue volatility including: increased physical hedging (contractual sales) of hydropower output, maintenance of adequate liquidity, cost cutting efforts and implementation of retail rate changes or surcharges as needed.

Fitch's affirmation at 'AA+' reflects our view that the district has taken reasonable actions to moderate net wholesale revenue volatility at the distribution division going forward, and should attain stronger financial performance levels in 2012 - commensurate with the 'AA+' level. The Negative Outlook recognizes the fiscal challenge of managing an increased long power position post 2011-12 during a period of particularly unfavorable wholesale electricity market conditions and a slow economic recovery. On the plus side, hydrological conditions are currently estimated at 118% of average runoff past the Grand Coulee dam - likely positive for the district's 2011 non-firm sales for resale.

The district has further established sound financial and risk management policies designed to offset a severe stress case scenario (i.e. 75% of average hydrological conditions and average wholesale power prices in the $25 range for five consecutive years). Nonetheless, should the district fail to achieve projected stronger financial performance measures post 2012, negative rating action may result.

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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:
--'Revenue-Supported Rating Criteria', Oct. 08, 2010;
--'Public Power Rating Guidelines', March 28, 2011.

Applicable Criteria and Related Research:
U.S. Public Power Rating Criteria
http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=613065

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