STANDARD & POOR'S

PUBLIC FINANCE

Chelan County Public Utility District No. 1, Washington

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Credit Profile		
US$30.385 mil cons sys rev bnds rfdg ser 2009A&B due 07/01/2014		
Long Term Rating	AA/Stable	New
Chelan Cnty Pub Util Dist #1 (Chelan Hydroelec Cons Sys) sr lien		
Long Term Rating	AA/Stable	Affirmed

Rationale

Standard & Poor's Ratings Services has assigned its 'AA' long term rating to Chelan County Public Utility District No. 1, (Chelan or the district), Wash.'s consolidated system subordinate revenue notes, refunding series 2009 A and B. In our view, the rating is based the district's net revenue pledge. Standard & Poor's also affirmed its 'AA' rating on Chelan's consolidated system revenue obligations, both senior and subordinate lien. The affirmation reflects the strong business profile and modest financial risk of the district's consolidated system, which includes its electric, water, and wastewater utility; telecommunications unit; and the Lake Chelan hydroelectric project. The outlook is stable.

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 recently adopted subordinate operating lien resolution, legal protections have improved slightly. Consequently, Standard & Poor's does not distinguish between the two liens.

As of Dec. 31, 2008, the district had $713 million in hydroelectric consolidated system debt and $286 million in project debt at its Rocky Reach and Rock Island hydroelectric projects, although hydroelectric project offtakers under take-or-pay, cost-of-service contracts service more than half of this. In mid-2009, Chelan expects to sell about $57 million of new money and refunding bonds. The rates and charges of the retail utilities, as well as certain intersystem loan payments from the district's three large hydroelectric systems, secures the consolidated system bonds.

Established in 1936, Chelan owns and operates an electric distribution system, a telecommunications system, three major hydroelectric power generating projects (Rocky Reach, Rock Island, and Lake Chelan), and a small water and wastewater system. The district issues debt primarily through its consolidated systems bond resolution, a financing vehicle created in 1987, for issuing tax-exempt debt on behalf of both the retail utilities and the hydroelectric projects from which it gets most of its power. In 2007, it rescinded the consolidation of the Rocky Reach and Rock Island projects to preserve the flexibility in hydroelectric project financing arrangements.

Supporting Chelan's strong business profile ('3' on Standard & Poor's 10-point scale, 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 $18 per megawatt-hour (MWh) in 2008. Officials project the cost to increase modestly each year to about $19 per MWh during 2010-2012, assuming average hydrological conditions. The hydroelectric projects are competitive even under very low stream-flow conditions, as demonstrated most recently during the extreme 2000-2001 winter drought (the second-worst on record), when the production costs averaged a still-competitive $17 per MWh. Chelan officials estimate that under critical water conditions, project costs would remain below $25 per MWh, well less than the likely market price in the region under such a scenario. The district almost always has surplus power. Surplus power sales subsidize retail rates.

Like its mid-Columbia neighbors, Grant County Public Utility District (A+/Stable) and Douglas County Public Utility District (AA/Stable), Chelan sells far more power to contractual offtakers and the wholesale market than to its own retail system. The district's distribution system takes about a third of the aggregate 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 by 2012. The power sales contracts permit Chelan to charge offtakers for their allocable shares of operating and debt service costs, plus 15% rolling coverage on interest payments. The district's distribution system still has surplus capacity in nearly all months, even under very low water conditions. Short-term and market sales of surplus capacity, including sales to Alcoa Inc. and the Douglas County district, accounted for a significant portion of operating revenues at the retail system and an even larger percent of net revenues, given that margins on these sales exceed those at the retail level.

Debt service coverage (DSC) ratios at the consolidated system were 1.6x in fiscal 2008, which we view as strong; it was slightly down from 2007's 1.9x. DSC at the consolidated level remains highly sensitive to wholesale sales not made under long-term contracts. In fiscal 2009, below-average stream flows, combined with low market power prices lead to the emergence of a projected $19 million operating deficit for the year. Ordinarily, low stream flows are inversely correlated to market prices, which support greater stability in Chelan's wholesale revenues. In response, on April 27, 2009, the district's board approved a 9% surcharge on its retail rates for up to 12 months. In addition, management had implemented other measures to close the emerging budget gap, including deferring some capital expenditures, unpaid furloughs and wage increase give-backs for executives, and a hiring freeze. In our view, management's responsiveness should limit the losses, and combined with its very strong cash reserves, will be more than sufficient to weather declines in wholesale sales revenues in the next two years. Due to the nature of certain power sales contracts, we expect that Chelan will be able to increase net wholesale revenues by 2012, when its share of the Rocky Reach and Rock Island hydroelectric projects allocated to the consolidated system increases markedly.

Outlook

The stable outlook reflects our assessment of Chelan's strong financial policies regarding DSC and liquidity, as well as the district's low cost power supply. The outlook also reflects our expectation that management will continue to take budget actions to counter weaker sales forecasts that will enable Chelan to maintain sound liquidity levels.

Regulatory Compliance And Relicensing

The Federal Energy Regulatory Commission extended the license for Rocky Reach to 2052 as of February 2009. This followed a multi-year period when the project was operated under an annual license, following the July 2006 expiration of the former license. The license for Rock Island does not expire until 2028. In November 2006, Chelan received a 50-year license for Lake Chelan. At Lake Chelan, the net present value cost of implementing the license is projected to be approximately $72 million; the amount includes fish protection, mitigation, and enhancement measures, among other operating and capital costs.

Legal Provisions

We believe the debt service coverage levels for the rate covenant and additional bonds test contained in the legal provisions for consolidated system revenue bonds are weak overall. The senior consolidated system resolution, however, is effectively closed by a new resolution under which bonds were issued in 2007 and 2008. The newer resolution has different legal provisions that make some improvements from a credit perspective. These improvements include the addition of flow-of-funds provisions and a rate stabilization fund, as well as tighter language on the additional bonds test and rate covenants. The rate covenant for the consolidated system bonds requires Chelan to collect revenue that provides annual revenues, together with other unencumbered district funds, in an amount sufficient to pay operating expenses of the consolidated system and cover debt service by 1.25x. In addition, distribution system net revenues alone must meet a DSC test of 1x for senior bonds, while the subordinate-lien test allows the use of rate stabilization funds. Chelan maintains a debt service reserve for the consolidated system senior- and junior-lien bonds in the amount of maximum annual interest payable in any year. The 2008A notes will be issued on a lien subordinate to the 2007 and 2008 bonds.

Related Research

USPF Criteria: "Electric Utility Ratings," June 15, 2007

Ratings Detail (As Of 01-Jul-2009)		
Chelan Cnty Pub Util Dist #1 cons sys rev bnds rfdg (AMT) ser 2008B		
Long Term Rating	AA/A-1+/Stable	Affirmed

Ratings Detail (As Of 01-Jul-2009) (cont.'d)		
Chelan Cnty Pub Util Dist #1 cons sys rev bnds ser 2001A dtd 03/01/2001 due 01/01/2036		
Unenhanced Rating	AA(SPUR)/Stable	Affirmed
Chelan Cnty Pub Util Dist #1 Chelan Hydro Cons Sys rev bnds rfdg ser 2004A-E dtd 04/29/2004 due 01/01/2039 07/01/2005-2012 2014 2018 2020 2024 2027		
Unenhanced Rating	AA(SPUR)/Stable	Affirmed
Chelan Cnty Pub Util Dist #1 (Chelan Hydroelec Cons Sys) jr lien		
Long Term Rating	AA/Stable	Affirmed
Chelan Cnty Pub Util Dist #1 (Chelan Hydroelec Cons Sys) (taxable) sr lien		
Long Term Rating	AA/Stable	Affirmed
Chelan Cnty Pub Util Dist #1 cons sys rev		
Unenhanced Rating	AA(SPUR)/Stable	Affirmed
Chelan Cnty Pub Util Dist #1 (Chelan Hydroelec Cons Sys) cons sys rev		
Unenhanced Rating	AA(SPUR)/Stable	Affirmed

Many issues are enhanced by bond insurance.