New Issue: Chelan County Public Util. Dist 1, WA

MOODY'S ASSIGNS Aa2 RATING TO THE CHELAN COUNTY PUD CONSOLIDATED SYSTEM REVENUE BONDS

APPROXIMATELY $969 MILLION IN DEBT AFFECTED

Electric Utilities
WA

Moody's Rating

ISSUE		RATING
Consolidated System Revenue Bonds, Refunding Series 2007A		Aa2
Sale Amount	$93,750,000	
Expected Sale Date	05/30/07	
Rating Description	Electric Revenue	
Consolidated System Revenue Bonds, Series 2007 B (AMT)		Aa2
Sale Amount	$8,140,000	
Expected Sale Date	05/10/07	
Rating Description	Electric Revenue	
Consolidated System Revenue Bonds, Series 2007 C (Non-AMT)		Aa2
Sale Amount	$28,358,000	
Expected Sale Date	05/10/07	
Rating Description	Electric Revenue	

Opinion

NEW YORK, Apr 30, 2007 -- Moody's Investors Service has assigned a Aa2 rating to the Chelan County Public Utility District No. 1 Consolidated System Revenue Bonds, Refunding Series 2007A (AMT) in the amount of approximately $93.8 million and Series 2007 B&C (Fixed Rate) in the aggregate amount of up to $40 million. Moody's has also affirmed the Aa2 rating on the district's consolidated system senior lien revenue debt outstanding in the amount of $535.9 million, net of the refunding. Moody's has also affirmed the Aa2 rating on the district's Rock Island hydroelectric project revenue bonds outstanding in the amount of $291.3 million and the Aa2 rating on the district's Rocky Reach hydroelectric project revenue bonds outstanding in the amount of $11.8 million.

USE OF PROCEEDS: The Series 2007A bonds will be used to refund certain maturities of the district's Senior Consolidated System Bonds, Series 1996ABC&D and 1997A. The Series 2007B&C bonds finance various capital projects in support of the district's distribution system, Lake Chelan Project modernization, and Rock Island Project modernization.

LEGAL SECURITY: The bonds are being issued under a new resolution approved by the district board in March 2007 and are secured by a subordinate lien on net revenues of the district's newly defined consolidated system. This system includes the district's electric distribution enterprise, the Lake Chelan Hydroelectric Project, the water system, the wastewater system, and the fiber optics system. Unlike the "old" consolidated system (also known as the "Chelan Hydro Consolidated System") as defined in a 1976 resolution and a subsequent 1995 resolution, the "new" consolidated system does not include the Rocky Reach or Rock Island hydroelectric projects. Additionally, the lien has been closed on the bonds issued under the 1995 resolution. The rate covenant for the current offering is 1.25 times using available reserve funds and 1.00 times excluding available reserve funds. The additional bonds test is also 1.25/1.00 times. The reserve requirement for all three series of bonds is equal to maximum annual interest on the bonds. While Moody's believes the debt service reserve requirement is weak, this weakness is largely offset by the district's liquidity position and debt service coverage levels. Moody's does not distinguish between senior and subordinate lien debt in the ratings assigned because of the district's strong credit quality and ample cash resources available to pay its obligations.

INTEREST RATE DERIVATIVES: The Series A bonds are being issued as auction rate securities. In order to achieve a lower interest rate on the refunding bonds and to offset interest rate risk, the district has entered into a forward starting swap with two counter-parties. The district will pay a fixed rate of 3.752% and receive 70% of LIBOR. The swap counterparties are Bear Stearns Capital Markets (guaranteed by Bear Stearns Companies, rated A1) which is providing 70% of notional value and Lehman Brothers Special Financing (guaranteed by Lehman Brothers Holdings, rated A1) providing 30% of notional value. Additional termination events for the issuer include the downgrade of the district's long-term senior unsecured debt rating to below Baa1. Termination events for the counterparty include the downgrade of the counterparty's rating to below Baa3. The district's swap documents contain one way collateral provisions that require the counterparty to post collateral if they are rated below the two highest long-term investment grade rating categories. The swap payments to the counterparty are insured by XL Capital Assurance. The district's termination payments to the counterparty are not insured, and the district is not insured against the possibility of a termination payment. The effective date of the swap is May 31, 2007 and the termination date is July 1, 2032.

STRENGTHS

* The Rocky Reach and Rock Island Projects are two of the lowest cost resources in the U.S., even in low water years, and have strong operating records

* Take-or-pay power sales agreements for just over 70% of the three projects

* Conservative budgeting and forecasting practices result in sound financial operations and ample cash reserves

* License for Rock Island does not expire until 2028

CHALLENGES:

* Impact of future unpredictable low-water flows on hydroelectricity production costs

* Rocky Reach operating license expired in 2006. Project re-licensing with the Federal Energy Regulatory Commission (FERC) is a general credit risk that affects all Northwest hydro-based utilities since the outcome of the re-licensing process cannot be predicted.

*Meeting state renewable energy mandate

MARKET/COMPETITIVE POSITION: LONG TERM FUNDAMENTAL CREDIT STRENGTH IS LOW COST HYDRO SYSTEM

Fundamentally, the most important credit factor is Chelan's low cost hydro system and the district's access to transmission. The district owns and operates two major hydroelectric projects and one smaller project with nearly 2,000 MW of generation capacity: Rocky Reach (1,300 MW) and Rock Island (624MW) on the Columbia River, and Lake Chelan (48 MW). The district's cost of power has historically been well-below regional and national averages. The district's average cost of power, the bulk of which was from its own facilities, was $16.00/MWh in 2006. Even in critical water years the forecasted cost of power is not more than $25.00/MWh. By contrast the Bonneville Power Administration's Priority Firm rate in 2006 has averaged about $30.00/MWh. For the most part, the district can meet its full load requirements from its reserved share of its generation facilities.

While the district has several large wholesale customers, including investor-owned utilities and a subsidiary of Alcoa, which purchases electricity pursuant to firm power sale take-or-pay contracts, the risk is manageable given that little revenue margins are earned from these contracts. Moody's believes the very competitive prices charged for the capacity and energy insure wholesale customer retention. Sixty-eight percent of the power output from the district's hydro-generation is sold by take-or-pay contract, including to Puget Sound Energy (41% of allocated capacity), Alcoa (14%), Portland General Electric (8%), PacificCorp (3%) and Avista (2%), with the balance sold by the district's distribution system (30%).

An important consideration regarding these take-or-pay contracts is that any loss of any take-or-pay contracted load or of industrial load would allow the district to remarket that low cost power in the regional wholesale marketplace (including California), earning the margin between the low cost of the generation and market prices. Power purchasers also do not have the right of first refusal for any capacity that might become available upon expiration of the existing contracts. Under the Rocky Reach Power Sales Contracts, the non-defaulting parties have an obligation to take up to an additional 25% of their original share upon default by one of the purchasers. Any remainder above that amount would be available to the district and could be sold at market prices.

Moody's believes that Chelan's management has put in place the power marketing skills needed to ensure that the district can take advantage of the margins between its low cost structure and the market. The district has a formal power risk management policy and oversight process which is annually reviewed to ensure appropriate safeguards are in place.

FINANCIAL PERFORMANCE/ FINANCIAL POSITION: CONSISTENT RECORD OF SOUND FINANCIAL LIQUIDITY AND SATISFACTORY DEBT SERVICE COVERAGE MARGINS

An important credit strength is the district's sound financial record with satisfactory margins providing for the maintenance of reserves and ongoing internal financing of capital requirements. Average debt service coverage calculated by Moody's on all debt by the district's aggregate net revenues is satisfactory averaging 1.35 times during 2002-2006. Average coverage over the same period as defined under the new consolidated system resolution was 1.61 times by net revenues and 3.73 times including other available revenues as allowed under the resolution. In fiscal 2006 these coverage figures were 1.80 and 5.90 times, respectively.

Approximately two-thirds of the outstanding consolidated system bonds were issued for the benefit of the two major hydroelectric projects and are repaid via loan payments by those systems. In addition to the outstanding consolidated system bonds, a significant amount of the district's total outstanding debt is the Rock Island Project bonds which have sum-sufficient debt service coverage (including the loan repayments) since it is paid primarily as a cost of service take-or-pay contractual obligation. Debt service coverage for the Rocky Reach Project debt (including the loan repayments) is also sum-sufficient.

Overall rate flexibility is significant since the district's retail rates are substantially below the national average. The district's 2006 residential rates averaged 3.0 cents/kwh, while the national average residential rate was 10.6 cents/kwh. The district sets rates without external regulatory approval. The last rate increase was approximately 2.5% during fiscal 2000. The district has planned for the possibility of 9% rate increases annually through 2012, but the board has not yet approved these increases.

Moody's believes that the district's maintenance of sound reserve levels mitigates the revenue risks associated with a low water as evidenced in 2001. Over the last five years the district has maintained an average of $127.9 million in unrestricted reserves and in 2006 this figure was a substantial $224.4 million. For the aggregate system, days cash on hand was 1,577 and net working capital as calculated by Moody's is strong at 223.8% ($535.8 million). For the consolidated system, these figures were 807 and 98.7% ($218.4 million), respectively. The district's forecasted financial operations reflect a continuation of these sound financial results. Projected debt service coverage through 2012 of the current offering and the senior lien bonds is expected to average 1.72 times using net revenues, and 5.39 times when adjusting for other available revenues. The district also has targeted a floor of $75 million of available operating cash over the forecasted period.

DISTRICT'S HYDRO HAS PROVEN RESILIENT UNDER ADVERSE CONDITIONS; WHILE ENVIRONMENTAL RISKS DO EXIST, DISTRICT HAS CONTINUED TO MANAGE THEM WELL

Chelan PUD clearly has one of the lowest cost structures of any U.S. electric utility. The resiliency of the fundamental strength of the hydro-based system was tested in 2001 amidst the second worst water year on record and the dysfunction of the wholesale energy market that registered average energy prices for the first six months of 2001 in the $200/MWh range.

While the hydro strengths are clearly evident, hydroelectric project re-licensing with the Federal Energy Regulatory Commission (FERC) is a general credit risk that affects all Northwest hydro-based utilities since the outcome of the re-licensing process cannot be predicted. It should be noted, however, that over the past 25 years, no license extension application has been denied. The Rocky Reach Project license expired in June 2006 and is currently undergoing regulatory review while operating on annual license. No competing license applications have been filed. The State of Washington Department of Ecology issued a water quality certification in March 2006 and FERC issued a final environmental impact statement in August 2006. The district is still awaiting biological opinions from NOAA and US Fish & Wildlife. The district currently anticipates a $394 - $400 million licensing related costs over fifty years.

Whether or not there will be further requirements that could increase the district's capital costs beyond what is included in its current forecast remains uncertain and some additional costs are possible. The district has included in its projections the cost of the fish bypass system and other environmental mitigations at Rocky Reach. Importantly, the district has achieved an agreement with federal and state agencies in implementing the habitat conservation plan (HCP) focusing on salmon and steelhead that inhabit the mid-Columbia River.

Relicensing by the FERC is not required for Rock Island until December, 2028. The district received its 50 year license for the Lake Chelan Project on November 6, 2006.

CAPITAL PROGRAM: MAJOR CAPITAL NEEDS ARE MANAGEABLE

The district's debt ratio of 65.9% for the combined system is above the median of 52.6% for U.S. municipal electric generation and distribution utilities although the consolidated system's ratio is lower at 57.6%. Moody's notes, however, that these debt ratios are moderate for a public power issuer with such substantial generating assets. Moreover, Moody's notes that these ratios do not reflect the economic value of the two major projects, which in this case is likely to be considerable.

The bulk of the district's capital plan is represented by the $394 - $400 million cost to complete the re-licensing of Rocky Reach. This cost, however, is over a 50 year period and includes some costs already incurred, like $112 million for a fish bypass. Also, most costs over the next five years will be covered from payments made by the district's wholesale power purchasers. The district anticipates new bond issues of approximately $76 million in 2009 and $27.4 million in 2011, primarily for Rock Island modernization. For any future bonds for Rocky Reach licensing, these likely would be issued under a new resolution for Rocky Reach project debt, not bonds on parity with the current offering.

Outlook

Moody's has a stable credit outlook on the district's bonds given its limited exposure to the volatile wholesale power market, significant rate flexibility and sound financial results including its maintenance of comfortable reserves.

What Could Change the Rating - DOWN

The ratings could face downward pressure if the district encounters significant unanticipated capital needs, and challenges in its re-licensing application.

What Could Change the Rating - UP

The ratings could rise if the district successfully completes its re-licensing application without encountering significant additional costs, if the average cost of power declines relative to the market, and if financial operations and liquidity are maintained at current levels.

KEY INDICATORS

Service area estimated population: 69,791

Average number of metered customers, 2006: 44,486

Customer growth, 2001 - 2006: 3.0%

Consolidated System, fiscal 2006

Average power supply cost: $16.00/MWh

Debt service coverage per bond ordinance: 1.80x

Debt service coverage per bond ordinance with available funds: 5.90x

Net working capital as % of gross revenue: 98.7% ($218.4 million)

Days cash on hand: 807

Debt ratio: 57.6%

Rocky Reach Project, fiscal 2006

Type of facility: 11 turbine run-of-the-river hydroelectric dam

Nameplate capacity: 1,300 MW

Average power supply cost: $12.00/MWh

Availability factor: 96%

Rock Island Project, fiscal 2006

Type of facility: 18 turbine run-of-the-river hydroelectric dam

Nameplate capacity: 624 MW

Average power supply cost: $24.00/MWh

Availability factor: 98%

Lake Chelan Project, fiscal 2006

Type of facility: 2 turbine hydroelectric dam

Nameplate capacity: 48 MW

Average power supply cost: $11.00/MWh

Availability factor: 100%

DEBT OUTSTANDING

Rock Island Hydroelectric System Bonds: $291.3 million, rated Aa2

Rocky Reach Hydroelectric System Bonds: $11.8 million, rated Aa2

Consolidated System Bonds (1995 Resolution), net of refunding: $535.9 million, rated Aa2

Consolidated System Bonds (2007 Resolution), net of refunding: $133.8 million, rated Aa2

CONTACT

Debra Litchfield, Treasurer/Director of Finance, (509) 661-4578

Analysts

Patrick Ford
Analyst
Public Finance Group
Moody's Investors Service

Dan Aschenbach
Backup Analyst
Public Finance Group
Moody's Investors Service

Contacts

Journalists: (212) 553-0376
Research Clients: (212) 553-1653
