

Fitch Rates Chelan Cnty PUD's \$180M Consol Sys Rev Bds 'AA'

Fitch Ratings-NY-March 26, 2004: Chelan County Public Utility District No. 1, WA's (Chelan) \$110 million in fixed rate refunding series 2004 A,B,C,D and series 2005 E and F (forward delivery) subordinated hydro consolidated system revenue bonds, and up to \$70 million in new money series 2004 E (taxable) and F auction rate subordinated hydro consolidated system revenue bonds are all rated 'AA' by Fitch Ratings. The bonds are scheduled to price via negotiation the week of April 12, 2004 with Lehman Brothers and JP Morgan co-managing the underwriting. In addition, in excess of \$900 million, in aggregate outstanding senior and subordinate hydro consolidated system revenue bonds, and senior and subordinate Rock Island and Rocky Reach hydro project revenue bonds are all affirmed at 'AA' by Fitch Ratings. The Rating Outlook is Stable.

Despite Chelan's maintenance of senior and subordinate liens and project versus consolidated system debt, Fitch rates all obligations the same. The distribution and hydro generating projects are viewed as a consolidated, integrated system, with a closed hydro consolidated system senior lien. Chelan's operating lien is the subordinate consolidated system lien. Following this refunding, the district will have less than \$5 million of senior lien consolidated system debt remaining.

Chelan's (the utility) high credit quality stems from the utility's exceptionally low-cost hydroelectric power projects, very competitive retail electric rates (3.0 cents per kwh average delivered rate), solid financial performance with healthy unrestricted cash reserves (\$66 million as of Dec. 31, 2003). Chelan's low power costs reflects its ownership of three hydroelectric projects (Rock Island, Rocky Reach and Lake Chelan), with a combined generating nameplate capacity in excess of 2000 MW, and an estimated average production cost of 1.7 cents per kwh in 2003. Approximately 41% is currently allocated for use by Chelan's distribution system, and the rest is sold at cost via long-term contracts to northwest electric utilities (including Puget Sound Energy, Inc., Portland General Electric Co., PacifiCorp, and Avista Corp.).

Chelan's hydro allocation is usually sufficient to meet the distribution system's power requirements and Chelan is typically a net power seller, except on the very coldest

days in the winter. Chelan weathered the northwest power crisis and severe drought conditions in 2000-2001 fairly well in comparison to many of its peers, by offsetting expensive required power purchases on peak days with sales of surplus power during offpeak periods (sales were at relatively high energy prices). With the option to take an additional 41 MW per year of Rock Island output for its distribution system's power requirements, Chelan should remain generally long power in the future, except during the most severe dry water years coupled with extreme temperatures.

Chelan's management has also been proactive in managing fish and wildlife protection issues, as exhibited by the development of Habitat Conservation Plans (HCP) for the Rock Island and Rocky Reach hydroelectric projects. The HCPs provide for 'no net impact', or essentially 100% survival rate of anadromous fish via a combination of passage through the hydro project and fish hatcheries. The HCP, which required several years of consensus building to attain approval by numerous federal, state, and local stakeholders, helps set a boundary on long-term fish protection related expenditures. Chelan has filed with the Federal Energy Regulatory Commission (FERC) to incorporate the HCPs into the Lake Chelan and Rocky Reach re-licensing application. An agreement of this nature encompassing various interested parties, would be a positive factor in FERC's review of Chelan's re-licensing application.

The main credit concern is the re-licensing of the Lake Chelan (2004) and Rocky Reach (2006) hydroelectric projects, which requires approval by the FERC. As mentioned above, incorporation of the HCP into the FERC re-licensing filings is a plus for Chelan. However, while the HCP encompasses the protection of currently listed endangered fish species along the Columbia River, it does not address the potential expenditures should new species of fish be designated as endangered.

Another concern the past few years, is the escalation of Chelan's debt outstanding to just under \$1 billion in aggregate. The utility has been financing extensive upgrades and other capital improvements to the hydro projects, including the installation of fish bypass and other fish-related expenditures. Given the small size of the distribution system, Chelan is relatively highly levered as evidenced by the 7.80 times (x) total debt-to-

funds-available-for-debt service ratio (consolidated basis). The median for integrated retail systems in the rating category is 6.5x. Mitigating this concern is the low cost of power from the projects despite the large capital expenditures the past five years. Chelan's nearest competitor is Bonneville Power Administration, providing power to 40% of the northwest, with an average power cost (preference power) of roughly 3.2 cents per kwh - well above Chelan's average production cost of 1.7 cents per kwh.

Chelan County PUD No. 1 is an integrated electricity provider, with approximately 38,000 retail electric customers in central Washington. Chelan also maintains a small water and wastewater system, serving approximately 4,700 users and accounting for less than 2% of consolidated revenues in 2002.

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