

Balance 2007 STRATEGIC BUDGET PROCESS

2007 Preliminary Budget

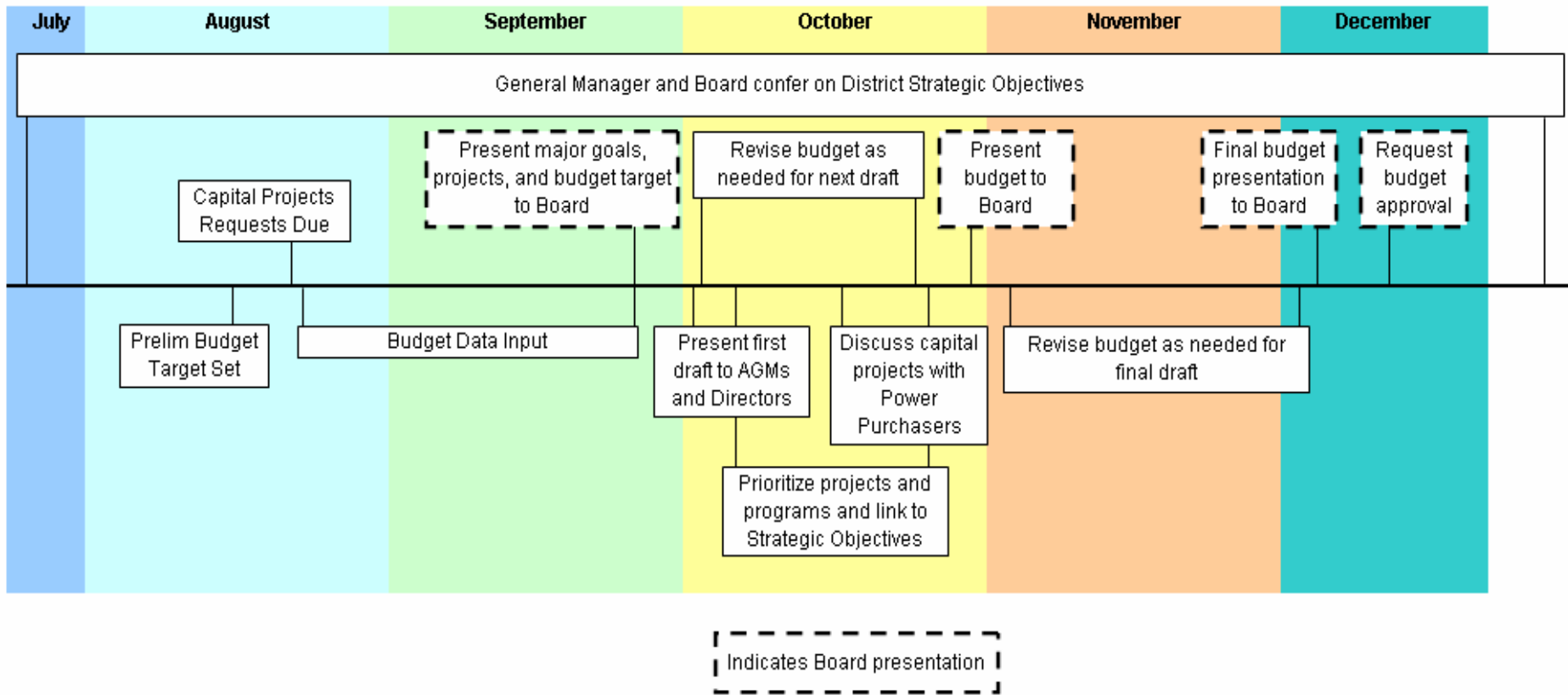
October 30, 2006



2007 Budget Highlights

- Target: Hold Operating Expense increase to 5%
- Process to get to current proposed budget
- Current Wholesale Revenue forecast
- Non-Hydro Debt Coverage Ratio Challenge
- Analyze Revenue Options

2007 Budget Timeline



Process to date

- Cross functional Budget Team formed
- Preliminary Budget Targets established
 - No more than 5% growth in O&M (excluding depreciation, net power supply, debt service and taxes)
 - Capital projects in line with 10-year capital plan
- Preliminary Budgets submitted
 - Aligned with Balanced Scorecard
 - Results exceeded Budget Target
- Directors prioritized budgets based on impact on reliability and service levels
- Budget team reviewed and recommended further reductions
- Preliminary Budget results compiled – presenting today

2007 Challenges

- RR & LC license implementations
- Aging Infrastructure - Hydro facilities, Electric and Water, Hatcheries, Parks
- Benefit cost increases
 - PERS, Healthcare, Retiree Medical (OPEB)
- Materials cost increases – fuel, steel, copper
- Contractor availability
- Wholesale Revenue Volatility



Budget Assumptions

Revenues

District Revenue Assumptions

- Electric Distribution
 - 5.7% load growth
- Networks
 - 2,000 new active connections
- Water/Wastewater
 - 4% customer increase
- Hydros – cost of service based

Wholesale Revenue Drivers

- Water
 - Volume
 - Timing of runoff
- Volatility of Market Prices
 - Natural gas, crude oil
 - Forward market
 - Preschedule market
 - Hourly market
- Structure of Alcoa 95/2000 Power Contract
- Local Average Temperatures
- Local growth

Wholesale Revenue Assumptions

- Retail Load Growth of 5.7%
- Alcoa: Two pot line operation
- 84% water
- Average flat price of \$63/mwh
- Will revisit before final budget

Water Forecast 2007

- Very little data
- It has been dry this fall
- Very mild El Nino
- Similar conditions have averaged 84% in 16 out of 17 years
- Requires a contingency plan

Year	Water
2003	86%
2004	84%
2005	89%
2006	102%

Water forecast is very important

Year	Revenue	Sold Forward	Bal aMW	Price	Water
2006	\$58.1M	\$24.4M @ \$63	45	\$60 \$54 \$44	90% 102%
2007	\$ 35.9M	\$15.50M @ \$63	30	\$63	84%

- Less water to sell forward during budget period
- Also less hedging opportunities during the year
- Market conditions different than 2006 (Record high Natural Gas)
- Alcoa uses more 95/2000 power during low water years

Projected Net Wholesale Revenue

Low	\$30.0 Million
Budget Estimate	\$35.9 Million
High	\$40.0 Million

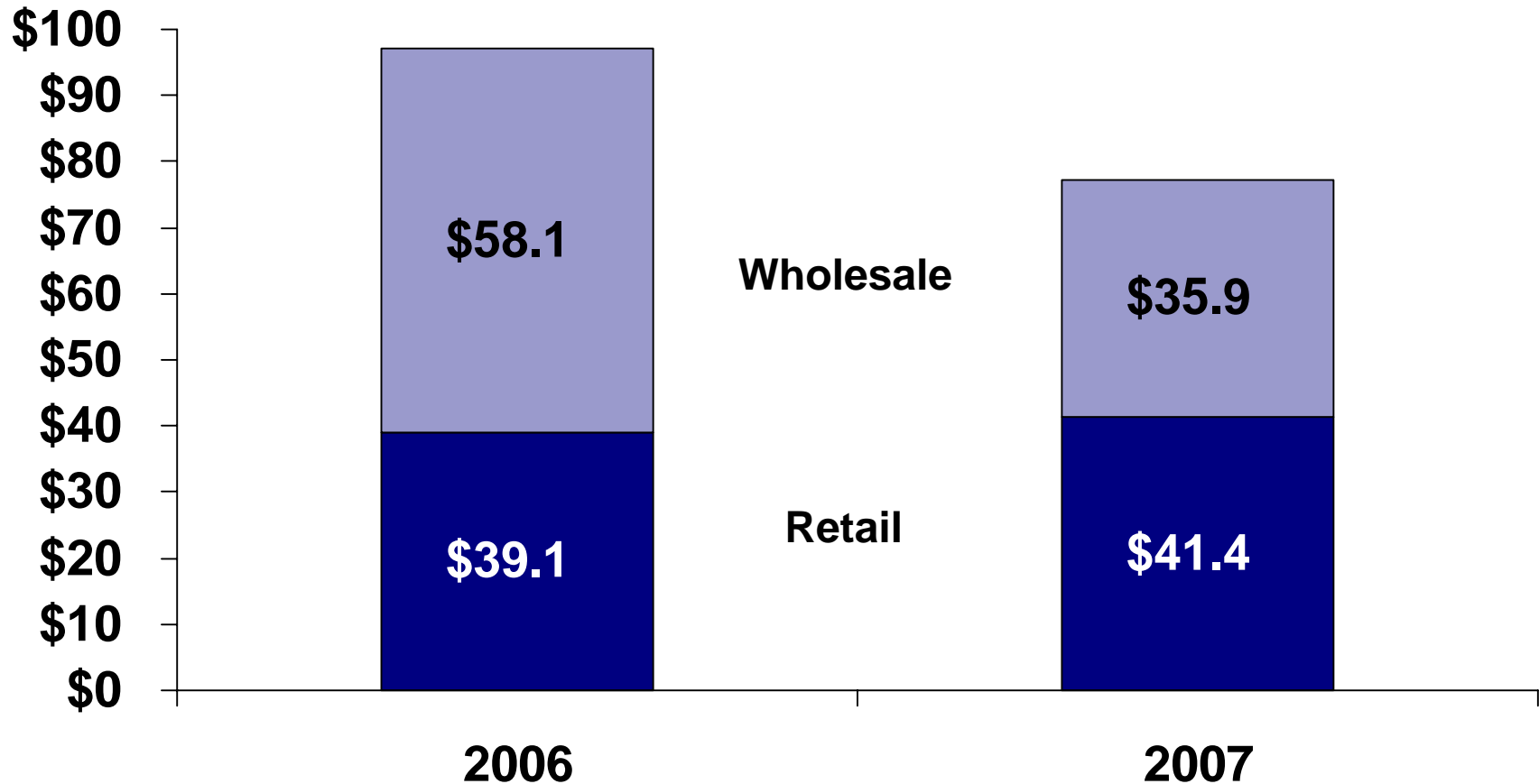
2006 Budget \$58.1 Million

Comparison 2006 v 2007

	+ / (-)	Balance (Millions of \$)
2006 Forecasted Net Wholesale Revenue		\$58.1
Lower projected water in 2007 (84% vs. 102%)	-17.0	41.1
Higher forward market prices (\$63 vs. \$44)	9.8	50.9
Lower expected Hedging Optimization (\$0.5M vs. \$10.1M)	-9.6	41.3
Higher Alcoa consumption at lower water levels (48,800 mwhs)	-1.9	39.4
Local Load Growth (82,344 mwhs)	-3.5	35.9
Total Expected 2007 Net Wholesale Revenue		\$35.9

Wholesale vs. Retail Revenue

(in millions)





Budget Assumptions

Expenses

Labor/Benefit Assumptions

- Bargaining unit wage adjustments
 - 3.69% contractual (6% including promotions, step increases)
- Non Bargaining unit wage adjustments
 - 3.8% pool (4.8% including promotions, market adjustments)
- Benefit cost increases
 - PERS – 3.69% to 5.28% at 1/1, increasing to 6.91% on 7/1
 - Healthcare – 18%
 - Other Post Employment Benefits (OPEB)
 - Current estimate \$2.4M in 2007

Staffing

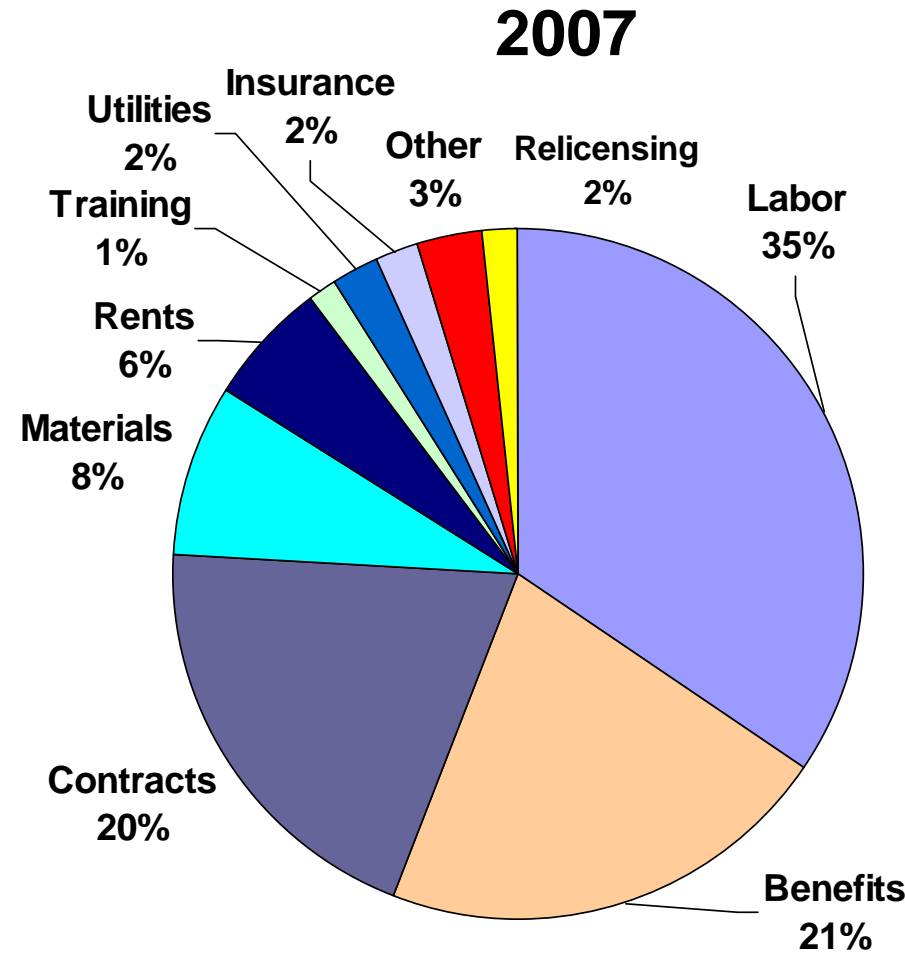
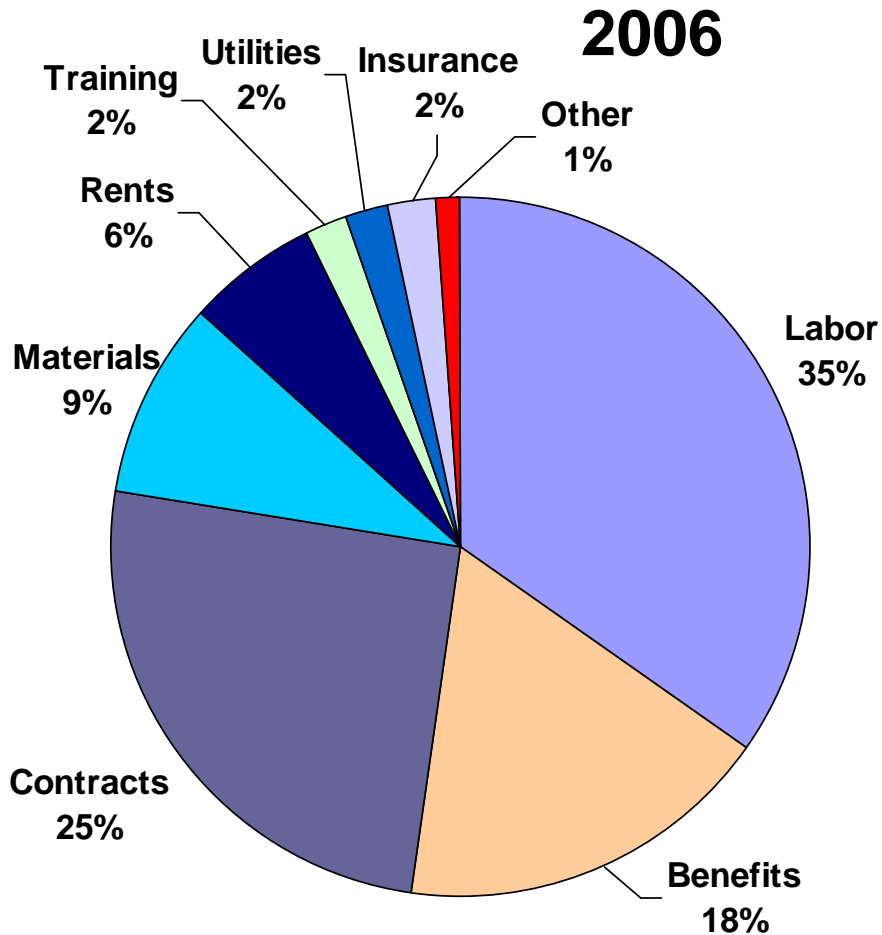
- Full Time Equivalents (FTEs)
 - 2007 Budget - 750
 - 2006 Budget - 769
- Reduce workforce through attrition
- Reduce contingent on-call work force
- New position:
 - Chief Risk Officer/Risk Manager
- 2 Pre-apprentice interns – Energy Technology Certificate Program (1040 hours)

New Significant Expenses

- Rocky Reach License Implementation
 - Assumes Q2 issuance
 - O&M \$1.4M
 - Capital \$1.3M
- Lake Chelan License Implementation
 - Assumes Q1 issuance
 - O&M \$770K
 - Capital \$4.4M
- Employee Benefit Costs
 - Other Post-Employment Benefits (OPEB)

Operating Expenses

(Excludes Purchased Power, Depreciation, Debt Service)





Preliminary Budget Results

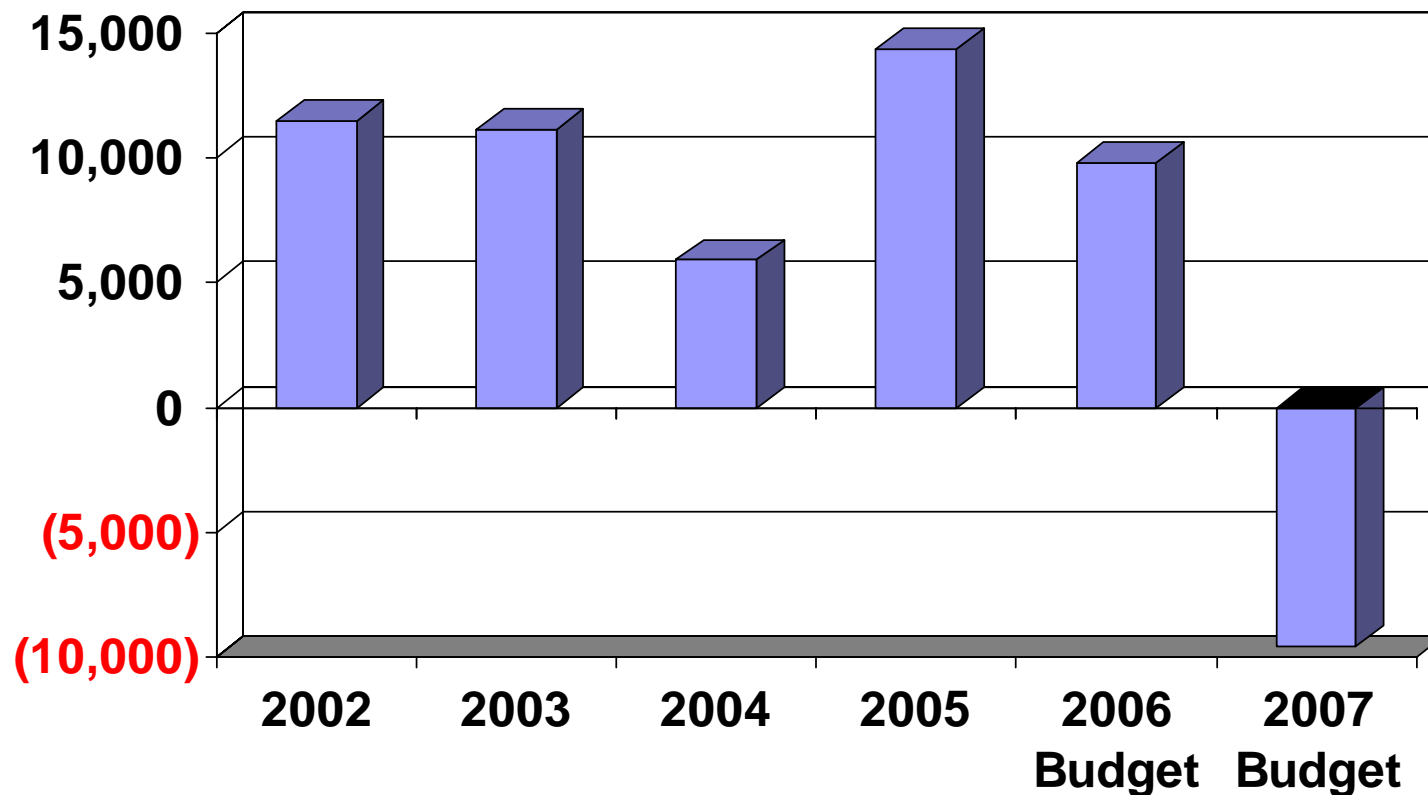
Income Statement

Combined Revenue and Expense

(in millions)

	2007	2006	
	Budget	Budget	Variance
Operating Revenue	208.8	199.1	4.9%
Operating Expense	119.6	113.4	5.4%
Net Power Supply	22.0	(4.8)	---
Deprec/Amort/Taxes	44.5	40.1	10.9%
Non-Operating Expense	36.6	44.5	(17.7%)
Chg in Net Assets Before CIAC	(14.0)	5.8	---
Capital Contributions (CIAC)	4.4	4.1	6.9%
Inc/(Dec) in Net Assets	(9.6)	9.9	---

Inc/(Dec) in Net Assets



Electric Distribution

(\$000s)

	2007	2006	
	Budget	Budget	Variance
Operating Revenue	42,321	40,604	1,717
Net Power Supply	22,023	(4,802)	26,825
Operating Expenses	26,056	24,399	1,657
Operating Income	(5,758)	21,007	(26,765)
Depreciation/Taxes	11,561	9,800	1,761
Non-Op Exp (Inc)	(7,026)	(2,336)	(4,690)
Cap Contributions	3,450	2,960	490
Inc/(Dec) in Net Assets	(6,842)	16,503	23,346

Networks

(\$000s)

	2007	2006	
	Budget	Budget	Variance
Operating Revenue	4,138	3,172	966
Operating Expenses	3,984	3,712	272
Operating Income	154	(540)	694
Depreciation/Taxes	3,944	2,832	1,112
Non-Op Exp (Inc)	4,299	3,240	1,059
Inc/(Dec) in Net Assets	(8,089)	(6,612)	(1,477)

Water

(\$000s)

	2007	2006	
	Budget	Budget	Variance
Operating Revenue	3,785	3,515	270
Operating Expenses	3,717	3,366	351
Operating Income	68	149	(81)
Depreciation/Taxes	1,492	1,429	63
Non-Op Exp (Inc)	1,015	722	293
Cap Contributions	861	900	(39)
Inc/(Dec) in Net Assets	(1,578)	(1,102)	(475)

Wastewater

(\$000s)

	2007	2006	
	Budget	Budget	Variance
Operating Revenue	400	409	(9)
Operating Expenses	562	634	(72)
Operating Income	(162)	(225)	63
Depreciation/Taxes	381	380	1
Non-Op Exp (Inc)	36	28	8
Cap Contributions	78	245	(167)
Inc/(Dec) in Net Assets	(501)	(388)	(113)

Rocky Reach

(\$000s)

	2007	2006	
	Budget	Budget	Variance
Operating Revenue	78,651	73,829	4,822
Operating Expenses	43,757	39,904	3,853
Operating Income	34,894	33,925	969
Deprec/Amort/Taxes	16,624	15,965	659
Non-Op Exp (Inc)	18,555	18,719	(164)
Inc/(Dec) in Net Assets	(285)	(759)	474

Rock Island

(\$000s)

	2007	2006	
	Budget	Budget	Variance
Operating Revenue	71,735	70,983	752
Operating Expenses	36,559	37,343	(784)
Operating Income	35,176	33,640	1,536
Deprec/Amort/Taxes	9,474	8,661	813
Non-Op Exp (Inc)	23,576	22,852	724
Inc/(Dec) in Net Assets	2,126	2,127	(1)

Lake Chelan

(\$000s)

	2007 Budget	2006 Budget	Variance
Operating Revenue	7,736	6,554	1,182
Operating Expenses	4,979	4,078	901
Operating Income	2,757	2,476	281
Deprec/Amort/Taxes	1,007	1,050	(43)
Non-Op Exp (Inc)	1,537	1,248	289
Inc/Dec in Net Assets	213	178	35



Preliminary Budget Results

Balance Sheet

Utility Services Cash Reserves

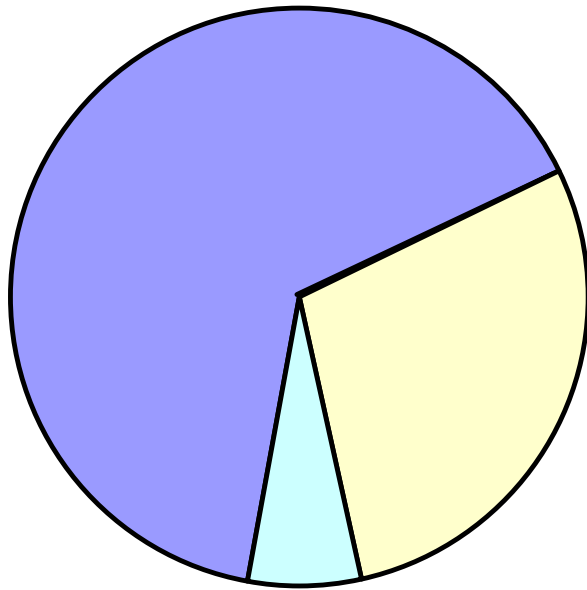
- Projected Ending Balance
 - 12/31/07 - \$178.8M
 - 12/31/06 - \$192.8M
- Avg. Rate of Return on Investments
 - 5.64% in 2007
 - 3.99% in 2006

Capital Expenditures





(\$000s)

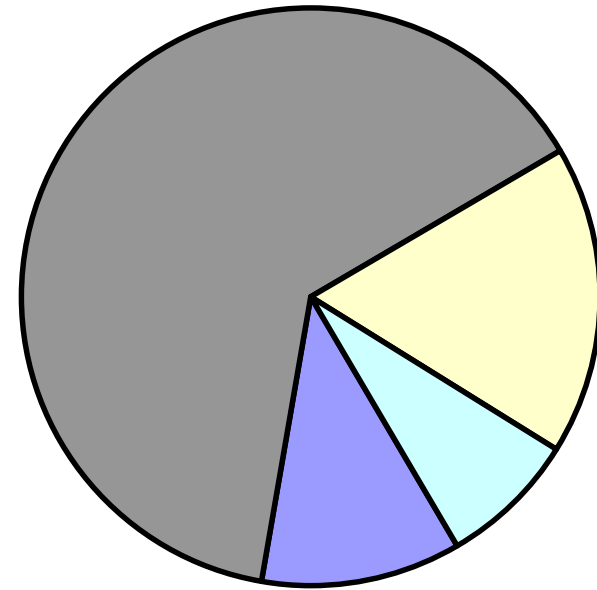
	2007	2006	
	Budget	Budget	Variance
Distribution	16,032	18,485	(2,453)
Networks	10,888	11,577	(689)
Water/WW	3,887	4,819	(932)
Rocky Reach	9,743	15,910	(6,167)
Rock Island	31,207	31,599	(392)
Lake Chelan	14,576	3,274	11,302
Internal Service	4,004	5,080	(1,076)
Total	90,337	90,744	(407)

Hydro Capital Financing (est.) (\$000's)






2006 Forecast

	Existing Bonds	\$ 27,924
	New Bonds	-
	Replacement Recovery	\$ 12,027
	Reserve & Contingency	<u>\$ 2,739</u>
Total Hydro Capital 2006		\$ 42,690

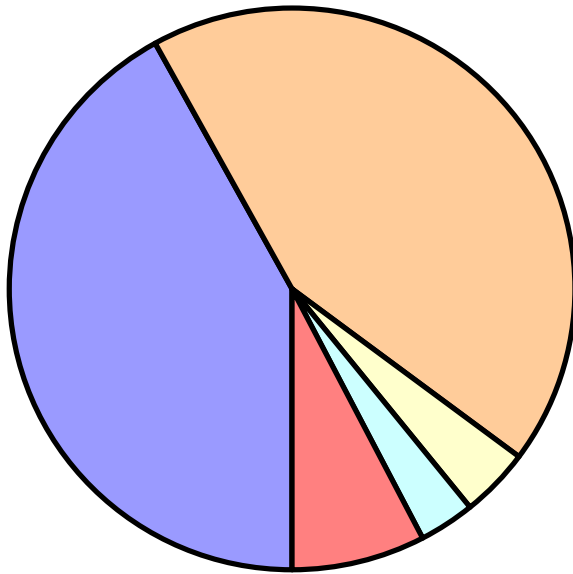


2007 Budget






	Existing Bonds	\$ 6,207
	New Bonds	\$ 35,511*
	Replacement Recovery	\$ 9,535
	Reserve & Contingency	<u>\$ 4,273</u>
Total Hydro Capital 2007		\$ 55,526

**Still evaluating options*

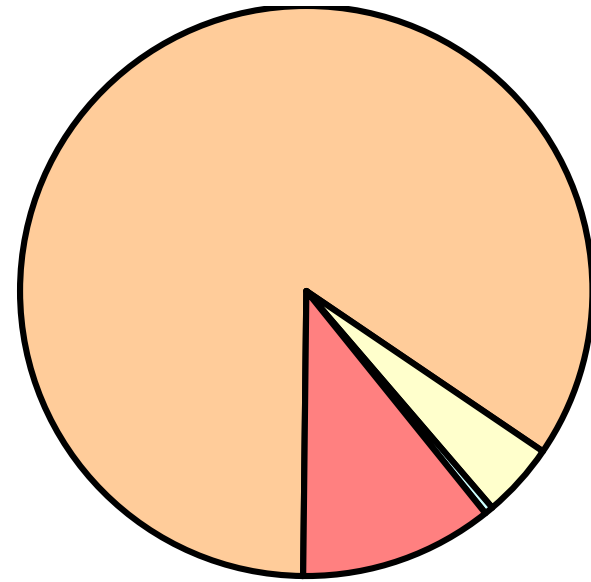
Non-Hydro Capital Financing (\$000's)








2006 Forecast

	Existing Bonds	\$ 15,019
	Cash	\$ 15,426
	Contributions in Aid	\$ 1,400
	Internal Service Rents	\$ 2,708
	Internal Service Res & Con	<u>\$ 1,143</u>

Total Non-Hydro Capital 2006 \$ 35,696



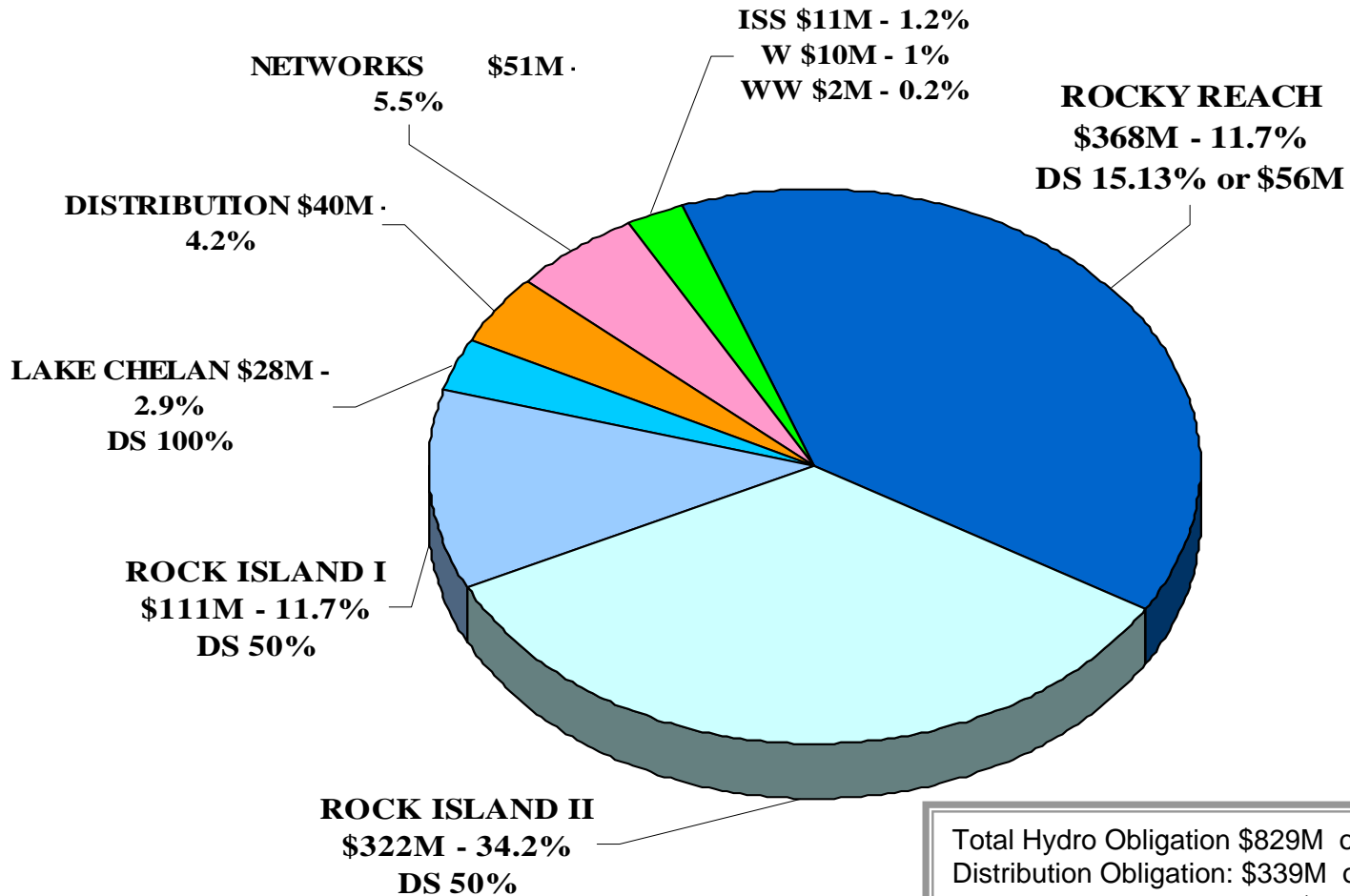
2007 Budget

	Existing Bonds	-
	Cash	\$ 29,407
	Contributions in Aid	\$ 1,400
	Internal Service Rents	\$ 3,755
	Internal Service Res & Con	<u>\$ 249</u>

Total Non-Hydro Capital 2007 \$ 34,811

Revenue Bonds & Related Loans Estimated 12-31-06

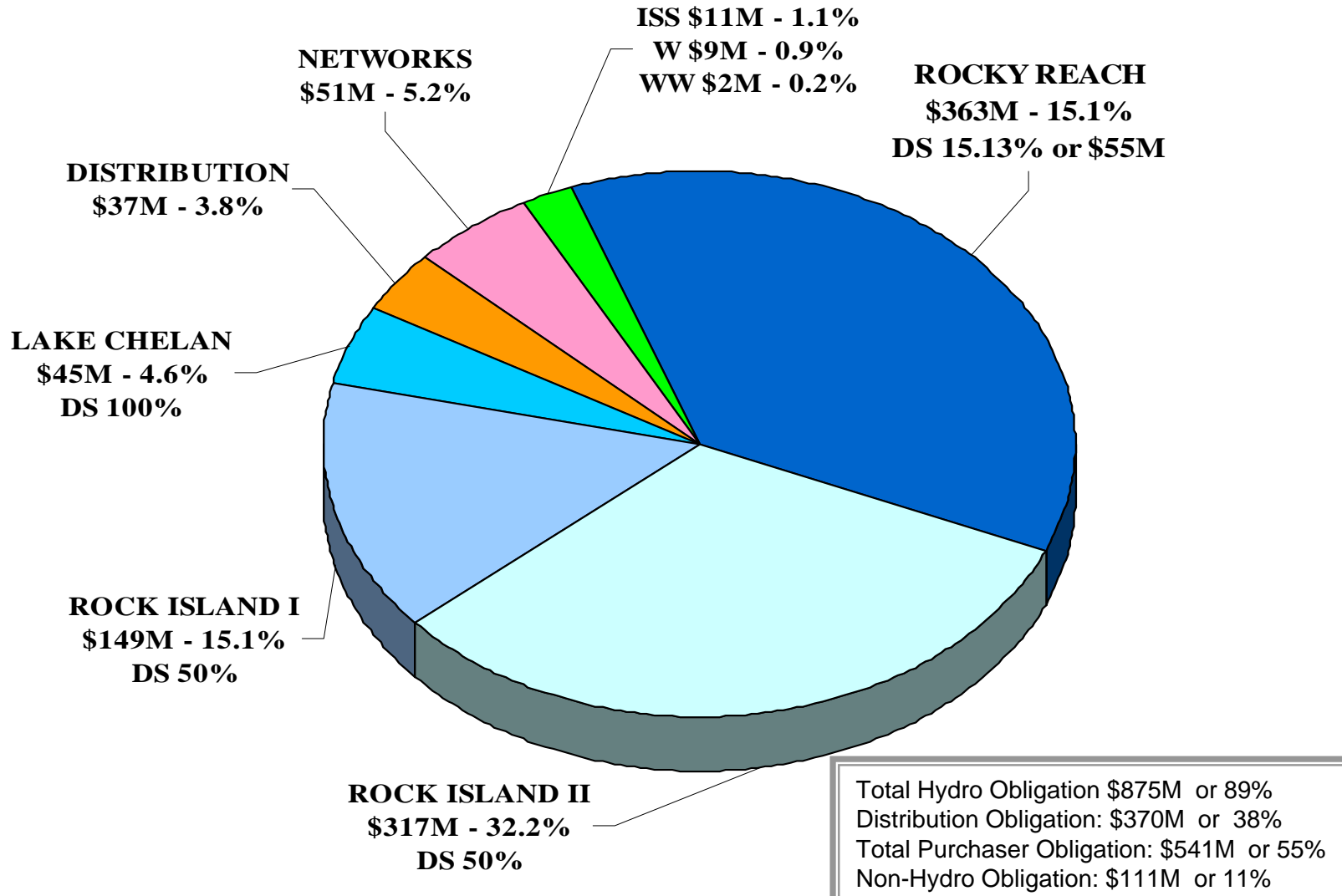
TOTAL \$942,480,032



Total Hydro Obligation \$829M or 88%
 Distribution Obligation: \$339M or 36%
 Total Purchaser Obligation: \$529M or 56%
 Non-Hydro Obligation: \$114M or 12%

Revenue Bonds & Related Loans Estimated 12-31-07

TOTAL \$985,282,313



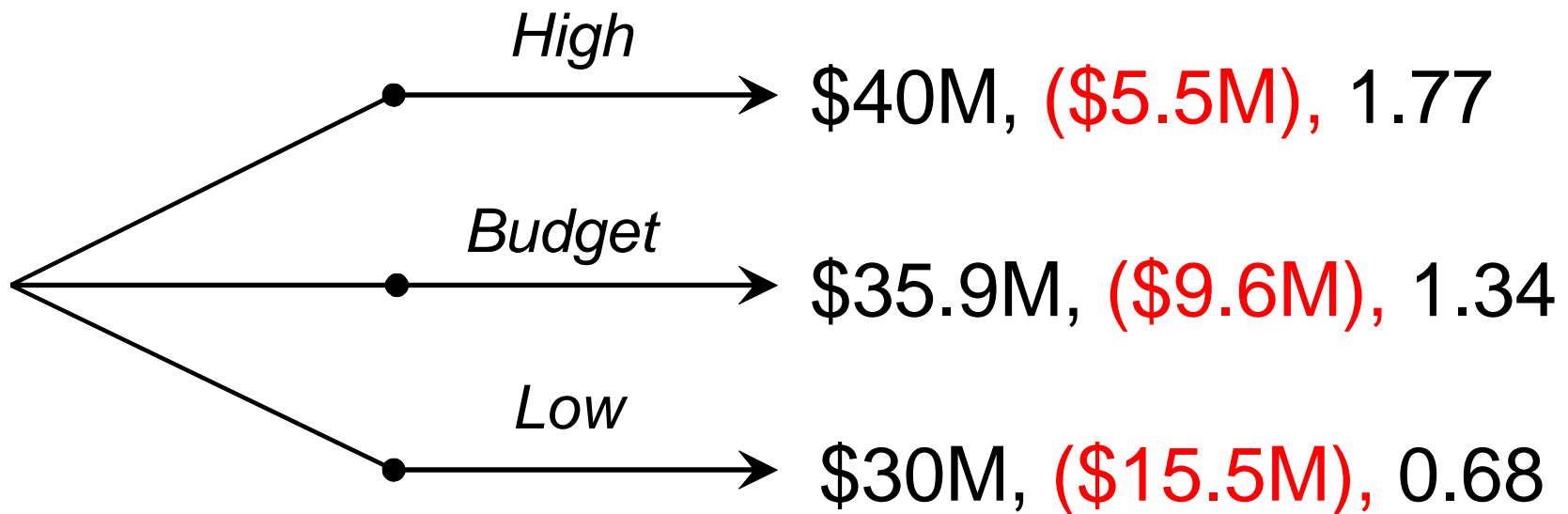
Debt Cover Ratio

- Measure of ability to service debt
- One measure of overall financial health
- Higher is better

- Hydro Debt Coverage Ratio
 - Covenant minimum 1.0x due to cost of service power contracts
- Non-Hydro Debt Coverage Ratio – A Key District Measure
 - 1.00x Covenant Minimum
 - 1.15x Covenant Minimum with Other Available Funds
 - 1.25x to issue new debt
 - 1.75x to support AA bond rating
- Debt Service Coverage Ratio =
$$\frac{\text{Operating Revenues} - \text{Operating Expenses}^*}{\text{Principal and Interest Payments}}$$

*Does not include capital costs nor depreciation expense

Wholesale Revenue impact on Net Assets and Non-Hydro Debt Cover



Net Wholesale Revenue, Inc (Dec) in Net Assets, Debt Cover

Budget Reduction Impact on Non-Hydro Debt Coverage

	2006 Budget	2007 as of 9/27/06	2007 as of 10/16/06	2007 as of 10/23/06
Operating Expenses	\$113.4M	\$125.0M	\$123.5M	\$119.6M
Net Wholesale Revenue	58.1M	37.3M	36.5M	35.9M
Debt Cover	3.18x	1.38x	1.36x	1.34x
Net Revenue needed for 1.75	(\$15.6M)	\$3.4M	\$3.6M	\$3.8M



Potential Risks/Consequences

- Reliability
- Customer Service levels
- Availability
- Forced Outage Rate
- Sustainability



Next Steps

- Continue public budget discussions
- Continue to prioritize and refine budget
- Consider OPEB funding choices
- Evaluate hydro funding options
- Integrate budget into long-term Strategic Planning Sessions
- Final Budget Hearing – December 4
- Request board approval – December 11



2007 Budget Highlights

- Target: Hold Operating Expense increase to 5%
- Process to get to current proposed budget
- Current Wholesale Revenue forecast
- Non-Hydro Debt Coverage Ratio Challenge
- Analyze Revenue Options