Fitch Ratings-New York-25 October 2011: Fitch Ratings has assigned an 'AA+' to Chelan County Public Utility District No. 1's (PUD) $164,425,000 consolidated system revenue bonds, refunding series 2011C (taxable), respectively.

The series 2011C (taxable) bonds, scheduled to price the week of Oct. 24 or 31, will be issued as fixed rate bonds and will be used to refund certain senior consolidated system bonds, and fund a reserve.

Fitch also affirms the 'AA+' rating on the following outstanding bonds (as of Sept. 30, 2011) issued by the district or by its wholly owned hydroelectric generating stations (Rocky Reach and Rock Island projects):

--$239.1 million senior consolidated system revenue/refunding bonds (which includes $164 million to be refunded with the 2011C bonds);
--$378.4 million subordinate consolidated system revenue/refunding (on parity with proposed 2011C);
--$82.7 million third lien consolidated system notes (due 2013-2014);
--$268.6 million, Rock Island Hydroelectric project revenue bonds (separately secured by project revenues only);
--$19.4 million, Rocky Reach Hydroelectric project revenue bonds (separately secured by project revenues only).

The Rating Outlook on all the bonds is Negative.

SECURITY:
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. For Rock Island and Rocky Reach project-specific bonds, the bonds are secured by a separate net revenue pledge for each 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 by the same team and operated as an integrated system, with loans flowing between the systems.

KEY RATING DRIVERS
Low Cost Hydro Power: Chelan County PUD's strong credit rating largely reflects its very low cost hydroelectric power resources, with a blended average production cost of 2.1 cents per kilowatt hour (kWh) for 2010.

Very Low Retail Rates: At the distribution system level, the district's average electric residential rates are among the lowest in the country at 3.4 cents per kWh delivered in 2010.

Strong Liquidity: 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).

Exposure to Wholesale Market and Hydro Conditions: Surplus power market sales accounted for 14% of total sales in 2010. These non-firm, shorter-term sales are subject to greater volatility primarily due to exposure to variable wholesale electricity market prices and hydrological conditions.
conditions. While market prices are expected to be low for at least the medium term, 2011 is proving to be a very strong water year for the Pacific Northwest.

Weakening of Coverage: Aggregate financial performance has been more variable recently. Debt service coverage for all debt obligations has ranged from a 1.83 times (x) (FY2007) down to 1.27x (FY2010) and is expected to remain depressed through at least 2012 given the relatively low wholesale electricity prices and slow economic recovery.

Debt Reduction Plan: Positively, the district has embarked on a debt reduction plan, and with no new debt financings projected through 2016 (it will internally fund 100% of capital expenditures), all-in debt is projected to decline by 36% (over $200 million more than was projected in March 2011) by 2016.

New Power Sales Contracts: 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.

Favorable Hydro Assets: The district also benefits from owning non-carbon emitting hydroelectric assets and is well positioned in meeting the state's renewable energy goals.

WHAT COULD TRIGGER A RATING ACTION
Depressed Metrics Beyond 2012: Maintenance of the 'AA+' rating for all systems depends upon the district achieving projected financial performance and leverage metrics commensurate with the rating category by FYE 2012 (including 2.0x debt service coverage for all debt obligations). Material deviation from the coverage projections and the inability to reduce debt as planned may result in negative rating action.

CREDIT PROFILE
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.

Fitch's affirmation at 'AA+' reflects our view that the district has taken reasonable actions to moderate net wholesale revenue volatility at the distribution system level and should attain financial performance levels in 2012 and beyond that are more commensurate with the 'AA+' rating level and the utility's historical performance. The Negative Outlook reflects the challenge of managing surplus power and higher debt service costs during a period of particularly unfavorable wholesale electricity market conditions and a slow economic recovery.

Second-quarter financial performance was better than the same period last year as net revenues were up due to both an increase in revenue and a decrease in operating expenses. Some of the improved performance is due to favorable hydrological conditions, which are currently estimated at 125% of average runoff past the Grand Coulee dam (through Oct. 1, 2011), that should continue to be a positive for the district's 2011 non-firm sales for resale and net revenue.
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Additional information is available at 'www.fitchratings.com'. The ratings above were solicited by, or on behalf of, the issuer, and therefore, Fitch has been compensated for the provision of the ratings.

Applicable Criteria and Related Research:
--'Revenue-Supported Rating Criteria', June 20, 2011;

Applicable Criteria and Related Research:
Revenue-Supported Rating Criteria
U.S. Public Power Rating Criteria

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