



## **Fitch Rates Chelan County (WA) Public Utility Dist \$48MM Sub Consolidated Revs 'AA'; Outlook Positive** [Ratings](#)

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Fitch Ratings-New York-15 February 2008: Fitch assigns a rating of 'AA' to Chelan County Public Utility District No. 1, Washington's (the district) \$48 million fixed rate subordinated consolidated system revenue bonds, refunding series 2008A. The 2008A (taxable) bonds are secured by the net revenues of the 'consolidated system', which includes the district's electric distribution, water, wastewater, telecom, and the Lake Chelan hydroelectric production systems. In addition, Fitch affirms the 'AA' rating on Chelan's associated \$491 million outstanding senior hydro consolidated system revenue bonds, \$128 million subordinate consolidated system revenue bonds, \$286 million of Rock Island project revenue bonds, and \$10.7 million Rocky Reach project revenue bonds. The Rating Outlook for all debt is revised to Positive from Stable. The 2008A bonds are scheduled to price on Feb. 26th, 2008, via negotiation.

The 2008A bonds are being issued to refund series 2004D auction rate securities insured by FGIC (rated 'AA'; Rating Watch Negative by Fitch). The refunding of the district's auction rate securities was triggered by the recent turmoil and uncertainty in the municipal auction rate markets. Fitch's 'AA' rating also takes into account the district's plan to convert its only other auction rate bonds, series 2007A (\$93.75 million), to variable rate demand obligations (series 2008B) with liquidity support in the form of a standby bond purchase agreement from US Bank. The district will retain for the series 2008B bonds the floating to fixed interest rate swap it executed in conjunction with the series 2007A to continue the synthetic fixed rate nature of those bonds. Fitch expects to rate the series 2008B bonds in the coming few weeks.

The district's high credit quality stems from its very low cost hydroelectric power resources, very competitive retail rates (average of 3.2 cents per kwh delivered), solid financial performance, with ample cash reserves, and successful federal operating relicensing of two of their three hydro projects thus far. The revised Rating Outlook centers on the anticipated 2008 federal relicensing of Chelan's largest and final hydroelectric project (Rocky Reach), management's development of a comprehensive strategic plan to begin to address the district's considerable surplus offsystem sales, more favorable contract terms in the recently negotiated long-term power sales agreement with Puget Sound Energy, and the district's projected notably stronger financial position post 2011, when the new power sales agreements take effect. Since the western energy crisis of 2001 and with the increasing state mandates for more renewable and 'greener' power resources, average wholesale electricity prices will continue to feel upward price pressure for the foreseeable future. The district is favorably poised to benefit from this power market environment given Chelan is a net seller of low-cost, renewable and generally 'green' hydroelectric power.

Credit risks are few and manageable and aside from obtaining final approval of the FERC operating license for the Rocky Reach hydroelectric project, include: exposure to varying hydrological conditions in the northwest and its impact on the district's significant net surplus power sales. As the existing hydropower sales agreements terminate in 2011-2012, the district's hydropower allocation will grow to 50% of the output from the combined Rock Island and Rocky Reach projects in 2012 (from 27% currently). As a result, surplus power sales will grow as well. For 2007, revenues from the resale of surplus power accounted for approximately 70.1% of the district's operating revenues. Resale revenues can be volatile, as they are directly affected by the volume of hydropower produced (which is a function of the water conditions) and the region's wholesale electricity market prices. The district's recently completed strategic plan provides initiatives to partially mitigate the district's dependence on net surplus power sales, including: implementing moderate annual retail rate increases, building up cash reserves, and accelerated paydown of distribution debt (non-hydro project debt).

Prospectively, to advance to the next credit rating level of 'AA+', Fitch will be monitoring the district's ability to attain the federal operating license for its final hydro project (Rocky Reach), to continue to maintain solid cash reserves and financial protection measures, and develop a power supply strategy to optimize its utilization of the increased share of hydropower coming to the district by 2012.

A final note, despite Chelan's various senior, subordinate, consolidated and project-specific liens, Fitch rates all long term obligations the same at 'AA'. While the distribution system and hydro generating projects are accounted for and financed separately, Fitch still views them as an integrated system. The senior consolidated system lien is now closed, and the subordinated consolidated system lien is the operating lien going forward.

Chelan County PUD No. 1 is an integrated electricity provider, with approximately 45,300 retail customers in central Washington. The retail distribution system is part of Chelan's 'consolidated system' and further includes: a small water and wastewater system (5,200 user/460 users), a fiber optics system (6,500 end users), and the Lake Chelan hydroelectric project (48 MW). As mentioned above, the district also owns two other large hydroelectric projects, the Rock Island and Rocky Reach projects, which may be separately financed and are accounted for separately.

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