

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

MOODY'S AFFIRMS CHELAN PUD 1, WASHINGTON'S CREDIT RATING AT Aa2

\$180 MILLION REFUNDING REVENUE BOND SALE SCHEDULED

Electric Utilities
 WA

Moody's Rating

ISSUE	RATING
Chelan Hydro Consolidated System Revenue Bonds, Refunding Series 2004 A, B, C, D and Series 2005 A, B	Aa2
Sale Amount \$180,000,000	
Expected Sale Date 04/15/04	
Rating Description Chelan Hydro Consolidated System Revenue Bonds, Refunding Series 2004 A,B,C,D and Series 2005 A,B	

Opinion

NEW YORK, Mar 30, 2004 – Moody's Investors Service has assigned a credit rating of Aa2 to the \$180 million Chelan County Public Utility District No. 1's Series 2004 A, B, C and D and Series 2005 A and B Consolidated System Revenue Bonds scheduled to price in April 2004. The current offering of bonds will include new money to fund certain capital projects at the District and refund approximately \$110 million of outstanding bonds for present value savings. The Series 2005 bonds are delayed delivery bonds. A debt service reserve is provided at maximum annual interest funded in part by bond proceeds and in part by a debt service reserve surety policy. Moody's also affirmed the credit rating of Aa2 on the outstanding \$611,245,000 Hydro Consolidated System senior and subordinate lien revenue debt. Moody's does not distinguish between senior and subordinate lien debt in the ratings assigned because of the district's strong credit standing and an absence of delineation between liens. Moody's has also affirmed the Aa2 credit rating on the district's \$ 305,314,000 Rock Island System revenue bonds and the Aa2 rating on the district's \$14,662,000 Rocky Reach System revenue bonds.

Moody's ratings reflect the following key considerations:

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 three major hydroelectric projects with over 2,000MW of generation capacity: Rocky Reach (1,287MW) and Rock Island (660MW) on the Columbia River, and Lake Chelan (59MW). The district's cost of power has historically been well-below regional averages. The district's average cost of power from the nearly 7.5 million megawatt hours produced from its facilities is estimated at \$17/MWh in 2003. Even in critical water years the forecasted cost of power is not more than \$21/mwh. By contrast the Bonneville Power Administration's Priority Firm rate in 2003 has averaged about \$32/MWh. For the most part, the district can meet its full load requirements from its reserved share of its generation facilities. While the district had to purchase some power in the wholesale energy market during the 2001 drought, there was limited financial impact, as evidenced by the district not having to raise retail electric rates like so many other utilities in the region.

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. The average industrial retail rate was about 2 cents/KWh in 2003. Fifty-nine percent of the power output from the district's hydro-generation is sold by take-or-pay contract, including to Puget Sound Energy (48% of allocated capacity), Portland General Electric (8%), PacificCorp (3%) and Avista (2%), with the balance sold by the

district's distribution system (24%). The district approved a new contract in 2001 with Alcoa, under which Alcoa has curtailed its operations and released its rights to purchase power from the district. Alcoa suspended local operations due to global economic pressures, not energy costs. In exchange for the release, the district sells Alcoa's share of Rocky Reach energy on the open market and returns market price less cost of generation and administrative expenses to Alcoa.

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 new capacity that might become available should any contracted party fail to meet its contractual obligation. 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 would 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 Power Risk Management Policy which is annually reviewed. Nonetheless, the still unsettled and uncertain power markets present potential risks with regard to the district's power marketing risk management. The district has a formal risk management policy and oversight process to ensure appropriate safeguards are in place.

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 is satisfactory at 1.33 times during 1996-2003. There is no General Fund transfer requirement similar to most other municipal power utilities in the U.S. A significant amount of the district's outstanding debt is the Rock Island Hydro debt that has sum-sufficient debt service coverage since it is paid primarily as a cost of service take-or-pay contractual obligation. Debt ratio is above the median for U.S. municipal electric generation and distribution utilities. Overall rate flexibility is significant since the district's retail rates are substantially below the regional average. The district's 2003 residential rates averaged 3.0 cents/kwh, while the national average residential rate was 8.9 cents/kwh. The district sets rates without external regulatory approval. No rate increases are forecasted for 2004 or 2005. Moody's believes that the district's maintenance of a sound reserve level mitigates the revenue risks associated with a low water as evidenced in 2001. Net working capital as calculated by Moody's is strong. The district's forecasted financial operations reflect a continuation of these sound financial results.

WHILE HYDRO ADVANTAGES ARE SIGNIFICANT, ENVIRONMENTAL RISKS DO EXIST

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, risks remain to the district's future cost structure. While Moody's believes these risks are present, the district has continued to manage them well. There does remain uncertainty about future fish and wildlife protection costs, including protection of endangered species. 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. Some additional costs can be expected. The district has included in its projections the cost of the fish bypass system 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.

REGULATORY RISK ON HYDRO RELICENSING, BUT DISTRICT REMAINS PROACTIVE

Hydroelectric project relicensing with the Federal Energy Regulatory Commission (FERC) is a general credit risk that affects all Northwest hydro-based utilities since the outcome of the relicensing process cannot be predicted. It should be noted that over the past 25 years, no license extension application has been denied. It also cannot be determined whether or not FERC will require mitigation and enforcement measures which could add cost to the operation of the hydro units. Relicensing by the FERC is required for the Rocky Reach Hydro Project by June 30, 2006 and for Rock Island, December 31, 2028. The district submitted the final license application for the Lake Chelan Project on March 31, 2002. In October 2003, the district submitted the Comprehensive Settlement Agreement, which the FERC is currently reviewing.

There is a tribal appeal of the Lake Chelan Project's water quality certification which has held up approval and pending.

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.

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