Fitch Rates Chelan County PUD's $30.4MM Consolidated System Subordinated Notes 'AA+'; Stable Outlook

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Fitch Ratings-New York-02 July 2009: Fitch Ratings assigns an 'AA+' rating to Chelan County Public Utility District No. 1 (the district) Washington's $21.9 million and $8.5 million series 2009A and 2009B, respectively, consolidated system subordinated notes. Outstanding ($53.7 million) parity subordinated revenue notes are affirmed at 'AA+' by Fitch. In addition, Fitch also affirms outstanding senior ($486.3 million) and subordinated ($173.3 million) consolidated system revenue bonds and hydroelectric project revenue bonds (aggregate $286.2 million). The Rating Outlook is Stable.

The fixed rate 2009 notes, with a three, four or five year maturity, are secured by a third lien net revenue pledge of the district's consolidated system, after payment of debt service on senior and subordinate lien consolidated system bonds. Fitch does not make a rating distinction between the three liens. The 2009 notes are scheduled to price July 8, 2009. The district intends to refinance the notes at maturity with long-term debt. Further details regarding the 2009 notes and Chelan's refinancing plan are available at the end of this release.

Chelan's 'AA+' rating is supported by very low cost hydroelectric power resources (average power cost of 18 mills/kwh), among the lowest retail electric rates regionally and nationally, ample distribution system cash reserves, and continued modest retail load growth despite economic downturn. Additionally, in February 2009, Chelan attained federal relicensing of Rocky Reach, its last and largest hydroelectric project, extending the project operating license another 43 years. With this relicensing, all of Chelan's hydropower projects have successfully extended their operating licenses, alleviating a key credit concern Fitch has historically noted. Other credit positives include strengthened financial targets (i.e., minimum cash reserves augmented to $130 million from $50 million), completion of a comprehensive strategic business plan, and more favorable new hydropower sales contracts that go into effect in 2011/2012.

Remaining credit concerns center on two related factors: exposure to varying hydrological conditions in the northwest and their impact on the district's distribution system net surplus or nonfirm power sales (46% of operating revenues for fiscal year 2008). As the existing hydropower sales agreements expire in 2011 and 2012, the district's hydropower allocation will increase to 47.8% of the output (from 30% currently) from the combined hydro projects. As a result, the district's surplus power sales will grow. Resale revenues however, can be very volatile, as experienced in fiscal year 2008, 2009 and likely into 2010, due to the effects of below average water availability in the northwest (2008-2009) and below average
wholesale electricity market prices (due to impacts of economic recession and associated depressed commodity prices).

For fiscal year 2009, the district implemented various cost cutting efforts and delayed nonessential capital expenditures to alleviate the loss in wholesale net margins. In addition, as of May 1, 2009, the district put into effect a 9% temporary (of up to 12 month) retail rate surcharge. It is important to note that the surcharge approved by the district's five member Board is less than what management had requested (18%). While the district has solid cash reserves (equivalent to 358 days operating cash for fiscal year 2008) to address the net revenue shortfall, the potential for substantial drawdown in cash reserves is a credit concern. Given the district's outstanding 5 year notes and variable rate bonds, each with refinancing risk and/or interest rate swap exposure, the ongoing disruption in capital markets, the economic recession and associated low commodity and wholesale power market prices, maintaining cash reserves is a key credit driver for the district. The district completed a strategic plan in 2008 that provided initiatives that could be used to mitigate its dependence on net surplus power sales, including: implementing annual retail rate increases, imposing rate surcharges if necessary, building of cash reserves, and/or accelerating paydown of distribution system debt.

The district's Stable Rating Outlook reflects Fitch's belief that the Board will take appropriate rate actions to maintain the financial strength of the distribution system during this likely 2-3 year period of financial challenges for the district. However, should the Board fail to maintain the distribution system's cash reserves and other strong financial metrics that have historically supported the 'AA+' rating, a negative rating action would be taken.

Chelan's Refinancing Plan: The 2009 notes are being issued to facilitate the refunding of Chelan's $30.4 million series 1999 senior consolidated system revenue bonds, subject to optional redemption as of July 1, 2009. In April 2006, the district entered into a forward starting interest rate swap (floating-to-fixed) with JP Morgan, with an effective date of June 1, 2009, in anticipation of the optional redemption of the 1999 bonds with floating rate securities. The district also procured in 2006 FSA municipal bond and interest rate swap insurance that would relate to the expected current refunding of the series 1999 bonds in 2009. However, current market conditions are not conducive to a variable rate refunding of the series 1999 bonds, as originally anticipated. The district has opted to privately place series 2009A and B variable rate consolidated system revenue bonds, which will be purchased by a trust, created by and for the district's benefit. Proceeds from the public sale of the 2009 notes will go to the trust to purchase the district's 2009 variable rate bonds.

Proceeds from the 2009 privately place bonds will refund the series 1999 bonds, thereby preserving the FSA municipal bond and swap insurance on those bonds (held in the trust). Chelan anticipates remarketing the 2009 bonds out in the capital markets at the end of the initial 3-5 year fixed interest rate mode period. At that time, the district would use the remarkeoted bond proceeds to retire the maturing 2009 notes. The district anticipates entering into a fixed-to-floating rate swap to match the 2009 bonds' initial fixed interest rate period.
and to offset exposure on the existing (JP Morgan) floating-to-fixed rate swap.

Chelan County PUD No. 1 is an integrated electricity provider, with approximately 47,600 retail customers in central Washington. The retail distribution system is part of Chelan's consolidated system which also includes: a small water and wastewater system, a fiber optics network, and the Lake Chelan hydroelectric generation facility (48 megawatts). The district also owns two other large hydroelectric facilities, the Rock Island and Rocky Reach projects, which are accounted for separately.

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