Global Power North America
New Issue

Chelan County Public Utility District No. 1, Washington

Ratings

New Issue

2002A , B, and C Hydro Consolidated System Junior Lien Bonds ....AA

Outstanding Debt

Security Class	Current Rating	Previous Rating	Date Changed
Hydro Consol Sys. Sr. Lien Bonds	AA	AA–	9/3/98
Hydro Consol Sys. Jr. Lien Bonds	AA	AA–	9/3/98
Rocky Reach Sr. Proj. Rev. Bonds	AA	AA–	9/3/98
Rock Island Sr. Proj. Rev. Bonds	AA	AA–	9/3/98
Rock Island Sub. Tax Proj. Rev. Bonds	AA	AA–	9/3/98

Rating Watch....None
Rating Outlook....Stable

Analysts

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Profile

Chelan County Public Utility District No. 1 is an integrated electric system providing service to roughly 38,000 retail customers in central Washington. In 2001, Chelan utilized 24% of its owned hydroelectric generating output for its native load; the remaining output was sold via long-term contracts to several utilities in the Northwest. Chelan also maintains a small water and wastewater system.

Key Credit Strengths

- Low-cost power and electric rates.
- Strong financial performer — even through severe drought of 2001.
- Habitat conservation plan helps contain expenditures on existing endangered fish.

Key Credit Concerns

- Two of the district's hydro projects require federal relicensing.
- Potential for new fish and/or wildlife to be listed as endangered in the future.

December 2, 2002

■ Rating Rationale

Chelan County Public Utility District No. 1's (Chelan, or the district) high credit quality stems from the utility's very low-cost hydroelectric power projects (averaging 1.5 cents per kilowatt-hour [kwh] production cost), exceptionally low electric retail rates (3.0 cents per kwh average delivered rate), strong financial performance, despite a severe drought in 2000–2001, and solid cash reserves. Chelan's management has been proactive in managing fish and wildlife protection issues, as exhibited by the development of the Habitat Conservation Plan (HCP), designed to help contain long-term fish-related expenditures while maintaining 100% fish survival rates. The HCP was initially signed off by the interested parties in 1998 and is expected to receive final regulatory approvals in 2003.

Main credit concerns center on the need to relicense the Lake Chelan (in 2004) and Rocky Reach (in 2006) hydroelectric projects, which require approval by the Federal Energy Regulatory Commission (FERC). Some of the factors in Chelan's favor with respect to relincensing: the district has a solid track record as an environmentally concientious steward of the hydro projects; the district has preserved the projects' low cost of power — providing economic value to the region; and the district's Rock Island project was successfully relicensed in 1989. An added credit concern is the potential for new fish/wildlife species to be designated as endangered in the future, which would not be covered by the existing HCP agreement.

■ New Issue Details

In aggregate, the $110 million subordinated hydro consolidated system revenue bonds, series 2002A, B, and C, are scheduled to price on Dec. 3, with Lehman Brothers as managing underwriter. The $45 million series 2002A and $35 million series 2002B proceeds will finance a portion of capital improvements and fish-related projects at the hydroelectric facilities. The bonds, subject to the alternative minimum tax (AMT), are structured as bullet maturities due on July 1, 2037. The $30 million series 2002C proceeds will fund capital expenditures at the electric distribution and water/wastewater systems. The 2002C (non-AMT) bonds are a combination of serial and term bonds with a final maturity of July 1, 2033.

Since 1995, the district's operating lien, for both the distribution and hydro generating systems, is the subordinated hydro consolidated system lien. For the hydroelectric projects, debt financings are usually obtained via borrowings from the consolidated system. The hydro projects' loan payments to the district are subordinate to the projects' own direct debt service. Despite the subordinated status of the consolidated system bonds, Fitch Ratings views the district and its

Financial Summary — Chelan County Public Utility District No. 1
($000, Years Ended Dec. 31)

	1997	1998	1999	2000	2001
Income Statement					
Operating Revenues	155,212	165,197	181,458	282,349	406,824
Operating Expenses	108,781	120,120	125,116	190,848	353,862
Operating Income	46,431	45,077	56,342	91,501	52,962
Other Income (Expenses)	(35,976)	(37,790)	(37,930)	(33,238)	(34,928)
Net Income	10,455	7,287	18,412	58,263	18,034
Adjustments to Income for Debt Service Coverage	29,350	32,018	32,596	38,318	60,817
Income Available for Debt Service	75,781	77,095	88,938	129,819	113,779
Total Annual Debt Service	49,692	56,284	62,686	59,840	63,338
Selected Balance Sheet Items					
Current Cash and Investments	50,429	51,256	62,755	104,867	98,852
Restricted Cash and Investments	105,861	112,770	117,694	115,956	240,784
Net Plant	836,150	851,437	854,425	868,399	888,946
Total Debt	726,386	730,235	747,386	730,462	854,412
Equity and/or Retained Earnings	254,986	263,619	283,518	343,354	363,022
Key Ratios					
Debt Service Coverage (x)	1.53	1.37	1.42	2.17	1.80
Days Cash on Hand	210	191	225	229	116
Operating Margin (%)	29.9	27.3	31.0	32.4	13.0
Net Margin (%)	6.7	4.4	10.1	20.6	4.4
Net Plant/Net Debt (x)	1.47	1.50	1.51	1.70	1.73
Equity/Capitalization (%)	26.0	26.5	27.5	32.0	29.8
Average Cost of Hydropower Production (Cents/kwh)	1.0	1.1	1.0	1.2	1.7

kwh – Kilowatt-hour. Source: Comprehensive annual financial report.

generating stations on an integrated basis, each benefiting from the same low-cost hydropower; therefore, all debt is equally rated.

Recent Developments

Chelan's three hydro projects (Rock Island, Rocky Reach, and Lake Chelan) have a combined generating capacity of slightly more than 2,000 megawatts (mw), of which approximately 24% was allocated for use by Chelan's distribution system in 2001. The rest was sold at cost via long-term, take-or-pay contracts to four Northwest investor-owned utilities and Alcoa Inc. (an aluminum company). In 2001, the average cost of Chelan's hydropower was 1.7 cents per kwh, which is higher than in previous years, but still significantly below Northwest spot power prices. The rise in 2001 average hydro production costs was a result of the Northwest's severe drought conditions (59% of normal water), which considerably reduced the projects' output. Additionally, Chelan's distribution system hydro allocation was occasionally insufficient to meet native load requirements, forcing Chelan to buy from the higher priced spot market. However, unlike many of its municipal and corporate utility counterparts in the region, Chelan's financial position was not compromised by the Northwest's second worst drought on record. In fact, Chelan generated $18 million in net income in 2001 despite the drought due to various initiatives, including aggressive conservation efforts, reduced spilling for fish, purchase of 24 diesel generators to mitigate peak hour exposure, and opportunistic surplus power sales (mostly off-peak periods). Chelan's surplus sales benefited from the unusually high off-peak electricity market prices in 2000–2001.

Financial Summary

Chelan has a history of strong financial performance even through years with low water conditions in the Northwest. Distribution system unrestricted cash reserves have been solid, ranging from $50 million to $100 million per year since 1996. As of Sept. 30, 2002, working capital and unrestricted reserves stood at $82.4 million, or approximately 90 days operating cash (excludes $109.9 million construction fund balance). The distribution system's debt service coverage (senior plus subordinate debt), historically 1.3x–1.5x level, actually rose to 1.8x–2.2x in 2000–2001, despite the critical water conditions in the

Northwest. While Chelan's hydro output was reduced, limiting available hydro for the district's native load, revenues from surplus sales substantially exceeded expensive peak hour purchases. The net result was $58.3 million and $18.0 million in net income for 2000 and 2001, respectively — well in excess of Chelan's prior three-year average net income of $8.5 million.

On a projected basis, including moderately higher capital expenditures in 2002–2003 for improvements at the Rocky Reach hydroelectric facility, reasonable retail sales growth, essentially average water conditions, and no retail rate increases, the distribution system's debt service coverage should remain solid through the forecast period (2002–2006) at roughly 2.0x.