

In the opinion of Bond Counsel, under existing federal law and assuming compliance with applicable requirements of the Internal Revenue Code of 1986, as amended (the “Code”), that must be satisfied subsequent to the issue date of the Bonds, interest on the Bonds is excluded from gross income for federal income tax purposes and is not an item of tax preference for purposes of the alternative minimum tax applicable to individuals. However, while interest on the Bonds also is not an item of tax preference for purposes of the alternative minimum tax applicable to corporations, interest on the Bonds received by corporations is taken into account in the computation of adjusted current earnings for purposes of the alternative minimum tax applicable to corporations, interest on the Bonds received by certain S corporations may be subject to tax, and interest on the Bonds received by foreign corporations with United States branches may be subject to a foreign branch profits tax. Receipt of interest on the Bonds may have other federal tax consequences for certain taxpayers. See “TAX MATTERS.”



\$67,625,000

**PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON
ELECTRIC SYSTEM REVENUE REFUNDING BONDS, SERIES 2013-J**

Bonds Dated: Date of Delivery

Due: January 1, as shown on the inside cover page

The Bonds are issuable only as fully registered bonds without coupons and, when issued, will be registered in the name of Cede & Co., as nominee of The Depository Trust Company (“DTC”), New York, New York. DTC will act as securities depository of the Bonds. Individual purchases will be made in book-entry form only, in the principal amount of \$5,000 and integral multiples thereof. Purchasers will not receive certificates representing their interest in the Bonds purchased. The fiscal agent of the State of Washington in New York, New York, currently The Bank of New York Mellon, has been appointed as the Paying Agent and Registrar for the Bonds.

Interest on the Bonds, first payable on January 1, 2014, and thereafter semiannually on July 1 and January 1 of each year, and principal of the Bonds are payable by the Paying Agent to DTC or its nominee, which is obligated to remit such principal and interest to its broker dealer Participants, which are obligated in turn to remit such principal and interest to the Beneficial Owners of the Bonds, as described in APPENDIX D—“BOOK-ENTRY SYSTEM.”

The principal of and interest on the Bonds are payable solely from and secured by the Gross Revenue of the Electric System and other funds pledged therefor by the Bond Resolution, subject to prior application for payment of Operating Expenses. Additional bonds payable on a parity with the Bonds and the District’s Electric System Revenue and Refunding Bonds, Series 2011-I (the “2011 Bonds”) may be issued subject to certain requirements. The 2011 Bonds are currently outstanding in the principal amount of \$140,480,000, of which \$56,765,000 will be refunded with proceeds of the Bonds. See “SECURITY FOR THE PARITY BONDS.”

The Bonds will be subject to redemption prior to maturity as described herein under “DESCRIPTION OF THE BONDS—Optional Redemption” and “—Mandatory Redemption.”

THE BONDS ARE SPECIAL LIMITED OBLIGATIONS OF THE DISTRICT AND ARE NOT OBLIGATIONS OF THE STATE OF WASHINGTON OR ANY POLITICAL SUBDIVISION THEREOF OTHER THAN THE DISTRICT, AND NEITHER THE FULL FAITH AND CREDIT OF THE DISTRICT NOR THE TAXING POWER OF THE DISTRICT NOR THE REVENUES OF ANY UTILITY SYSTEMS OF THE DISTRICT OTHER THAN THE NET REVENUE OF THE ELECTRIC SYSTEM, ARE PLEDGED TO THE PAYMENT OF THE BONDS.

The maturity schedule for the Bonds is set forth on the inside cover page.

This cover page is not intended to be a summary of the terms of, or security for, the Bonds. Investors are advised to read the entire Official Statement to obtain information essential to the making of an informed investment decision.

The Bonds are offered when, as and if issued and received by the Underwriters, subject to the approval of legality by Foster Pepper PLLC, Seattle, Washington, Bond Counsel, and certain other conditions. Certain legal matters will be passed upon for the Underwriters by their counsel, K&L Gates LLP, Seattle, Washington. The Bonds are expected to be delivered on or about September 18, 2013, through the facilities of DTC in New York, New York, by Fast Automated Securities Transfer.

J.P. Morgan

Citigroup

Dated: September 5, 2013

MATURITY SCHEDULE, INTEREST RATES, YIELDS AND CUSIP NUMBERS

\$67,625,000
Electric System Revenue Refunding Bonds, Series 2013-J

Maturity (January 1)	Amount	Interest Rate	Initial Reoffering Yield	CUSIP No.*
2024	\$ 2,405,000	5.00%	3.74%**	387874WR7
2025	2,525,000	5.00	3.94%**	387874WS5
2026	2,650,000	5.00	4.10%**	387874WT3
2027	2,785,000	5.00	4.29%**	387874WU0
2028	2,920,000	5.00	4.40%**	387874WV8
2029	3,070,000	5.00	4.54%**	387874WW6
2030	3,220,000	5.00	4.67%**	387874WX4
2031	3,385,000	5.00	4.76%**	387874WY2
2032	3,550,000	5.00	4.84%**	387874WZ9
2033	3,730,000	5.00	4.90%**	387874XA3

\$21,635,000 5.00% Term Bond due January 1, 2038, initial reoffering yield of 5.06%; CUSIP No. 387874XB1*

\$15,750,000 5.00% Term Bond due January 1, 2041, initial reoffering yield of 5.12%; CUSIP No. 387874XC9*

* The CUSIP data herein is provided by the CUSIP Global Services, managed on behalf of the American Bankers Association by Standard and Poor's. The CUSIP numbers are not intended to create a database and do not serve in any way as a substitute for CUSIP service. CUSIP numbers have been assigned by an independent company not affiliated with the District and are provided solely for convenience and reference. The CUSIP numbers for a specific maturity are subject to change after the issuance of the Bonds. Neither the District nor the Underwriters take responsibility for the accuracy of the CUSIP numbers.

** Priced to the July 1, 2023 par call date.

No dealer, broker, salesperson or any other person has been authorized by the District or the Underwriters to give any information or to make any representation, other than the information and representations contained herein, in connection with the offering of the Bonds and, if given or made, such information or representations must not be relied upon as having been authorized by any of the foregoing. This Official Statement does not constitute an offer to sell or solicitation of an offer to buy any of the Bonds in any jurisdiction in which it is unlawful to make such offer, solicitation or sale.

The information set forth herein has been obtained from the District and other sources that the District believes to be reliable, but it is not guaranteed as to accuracy or completeness and is not to be construed as a representation by the Underwriters. The information herein is subject to change without notice, and neither the delivery of this Official Statement nor any sale made hereunder shall, under any circumstances, create any implication that there has been no change in the affairs of the District since the date hereof.

The Underwriters have provided the following sentence for inclusion in this Official Statement. The Underwriters have reviewed the information in this Official Statement in accordance with, and as part of, their responsibilities to investors under the federal securities laws as applied to the facts and circumstances of this transaction, but the Underwriters do not guarantee the accuracy or completeness of such information.

The achievement of certain results or other expectations contained in forward-looking statements in this Official Statement involves known and unknown risks, uncertainties and other factors that may cause actual results, performance or achievements described to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. The District does not plan to issue any updates or revisions to those forward-looking statements if or when its expectations or events, conditions or circumstances on which such statements are based occur.

The Bonds will not be registered under the Securities Act of 1933, as amended, or any state securities laws in reliance upon exemptions contained in such laws. The Bonds will not have been recommended by the Securities and Exchange Commission ("SEC") or any other federal, state or foreign securities commission or regulatory authority, and no such commissions and regulatory authorities will have reviewed or passed upon the accuracy or adequacy of this Official Statement. Any representation to the contrary may be a criminal offense.

PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY
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www.gcpud.org*

Commissioners

Terry Brewer President
Bob Bernd..... Vice President
Dale Walker Secretary
Thomas Flint..... Commissioner
Larry Schaapman..... Commissioner

Senior Management

Anthony Webb..... General Manager
Chuck Berrie..... Assistant General Manager
Kevin Nordt..... Chief Financial Officer
Mitch Delabarre..... General Counsel
Jeff Grizzel..... Director of Natural Resources
Debbie Lowe..... Director of Support Services
Mike McClenahan..... Director of Power Management
Andrew Munro..... Director of Customer Service
Bonnie Overfield..... Director of Finance
Dawn Woodward..... Director of Hydro

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Paying Agent and Registrar
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The Bank of New York Mellon
New York, New York

Financial Advisor

Public Financial Management, Inc.
Los Angeles, California

* The District's website is not part of this Official Statement and investors should not rely on information presented in the District's website in determining whether to purchase the Bonds. This inactive textual reference to the District's website is not a hyperlink and does not incorporate the District's website by reference

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PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

OFFICIAL STATEMENT

RELATING TO

\$67,625,000

ELECTRIC SYSTEM REVENUE REFUNDING BONDS, SERIES 2013-J

INTRODUCTION

The purpose of this Official Statement, which includes the cover page, inside cover page and appendices, is to set forth information concerning Public Utility District No. 2 of Grant County, Washington (the “District”), the District’s electric transmission, distribution, telecommunications and generating system (the “Electric System”), the District’s Priest Rapids Hydroelectric Project (the “Priest Rapids Project”), which consists of the Priest Rapids Development and the Wanapum Development, and the District’s \$67,625,000 principal amount of Electric System Revenue Refunding Bonds, Series 2013-J (the “Bonds”).

The Bonds are to be issued pursuant to Title 54 of the Revised Code of Washington (“RCW”) (the “Enabling Act”) and Chapters 39.46 and 39.53 RCW. The Bonds are authorized by Resolution No. 8682 of the District, adopted on July 22, 2013 (the “Bond Resolution”).

The District’s Electric System Revenue and Refunding Bonds, Series 2011-I (the “2011 Bonds”), are outstanding in the amount of \$140,480,000, of which \$56,765,000 will be refunded with proceeds of the Bonds. The Bonds, the 2011 Bonds and bonds issued on a parity therewith pursuant to the Bond Resolution (“Future Parity Bonds”) are hereinafter referred to as the “Parity Bonds.”

Certain capitalized words and phrases used in this Official Statement have the meanings as defined in the Bond Resolution, unless the context clearly indicates that another meaning is intended. See APPENDIX A—“SUMMARY OF CERTAIN PROVISIONS OF THE BOND RESOLUTION—Certain Definitions.”

PURPOSE AND APPLICATION OF BOND PROCEEDS

Purpose of the Bonds

The Bonds are being issued to refund a portion of the 2011 Bonds as described in the following subsection, to fund the Reserve Fund, and to pay costs of issuance of the Bonds.

Refunding Plan

The following bonds (the “Refunded Bonds”) will be refunded to their maturity dates with a portion of the proceeds of the Bonds.

Refunded Bonds				
Bond	Maturity Date	Par Amount	Interest Rate	CUSIP Numbers
<i>Electric System Revenue and Refunding Bonds, Series 2011-1</i>				
Serials	2014	\$ 6,000,000	5.00%	387874WN6
	2015	11,160,000	5.00	387874WP1
	2016	10,025,000	3.00	387874VX5
	2016	2,670,000	5.00	387874WQ9
	2017	300,000	3.00	387874WF3
	2017	12,830,000	5.00	387874VY3
	2018	3,675,000	3.50	387874WG1
	2018	10,105,000	5.00	387874VZ0
Total		\$56,765,000		

A portion of the net proceeds from the sale of the Bonds will be deposited in the Refunding Account (the “Refunding Account”) and used to purchase Acquired Obligations (as defined below) to be held by The Bank of New York Mellon (the “Escrow Agent”) under an escrow agreement (the “Escrow Agreement”), dated the date of delivery of the Bonds, between the District and the Escrow Agent. Funds will be irrevocably deposited in the Refunding Account and will be used to purchase direct, noncallable obligations of the United States of America (the “Acquired Obligations”). The Acquired Obligations will mature at such times and pay interest in such amounts so that, with other available funds held by the Escrow Agent under the Escrow Agreement, sufficient money will be available to pay the interest on the Refunded Bonds coming due on and prior to their respective maturity dates and to retire the Refunded Bonds on their maturity dates, as set forth above. Since all payments of principal of and interest on the Refunded Bonds will thereafter be provided for from money and securities on deposit with the Escrow Agent under the Escrow Agreement, the liens, pledges and covenants securing the Refunded Bonds will terminate and be discharged and released.

An independent verification shall be obtained from Samuel Klein and Company, Certified Public Accountants, stating that the Acquired Obligations held by the Escrow Agent and the interest to be earned thereon, together with any money held by the Escrow Agent, will be sufficient to make all interest payments to the maturity dates for the Refunded Bonds and to pay the principal and premium, if any, of the Refunded Bonds on their maturity dates. The verification will also confirm the correctness of the mathematical computations supporting the conclusion of Bond Counsel that the Bonds are not “arbitrage bonds” as defined by Section 148 of the Internal Revenue Code of 1986, as amended.

Application of the Bond Proceeds

The proceeds of the Bonds are expected to be applied as follows:

Sources and Uses

Sources of Funds

Principal Amount of the Bonds	\$ 67,625,000
Net Original Issue Premium	<u>814,499</u>
Total Sources of Funds	\$ 68,439,499

Uses of Funds

Deposit to Refunding Account	\$ 62,106,918
Deposit to Reserve Fund	5,787,500
Underwriter's Discount and Issuance Costs(1)	<u>545,081</u>
Total Uses of Funds	\$ 68,439,499

(1) Includes underwriters' discount, bond counsel fees, financial advisor fees, rating fees, legal fees, Escrow Agent fees, and verification agent fees and costs of posting and printing this Official Statement.

DESCRIPTION OF THE BONDS

General Terms

The Bonds will be issued in the aggregate principal amount of \$67,625,000 and will be dated the date of their delivery. The Bonds will bear interest at the rates per annum set forth on the inside cover page hereof, payable January 1, 2014, and semiannually thereafter on each July 1 and January 1, and will mature on January 1 in each year as set forth on the inside cover page hereof.

The Bonds will be issuable in registered form, in the denomination of \$5,000 or any integral multiple thereof within a single maturity. Interest is calculated based on a 360-day year consisting of 12 months of 30 days each. The fiscal agent of the State of Washington in New York, New York, currently The Bank of New York Mellon, is the initial Registrar and Paying Agent for the Bonds.

The Bonds will be issued in fully registered form initially in the name of Cede & Co., as registered owner and nominee of The Depository Trust Company, New York, New York ("DTC"). DTC will act as securities depository for the Bonds. Individual purchases may be made in book-entry form only as described below. Purchasers will not receive certificates representing their interest in the Bonds purchased. So long as Cede & Co. is the registered owner of the Bonds, as nominee of DTC, references herein to the "registered owners" or "bondowners" shall mean Cede & Co. and shall not mean the "Beneficial Owners" of the Bonds. In this Official Statement, the term "Beneficial Owner" shall mean the person for whom a DTC participant or indirect participant acquires an interest in the Bonds.

So long as Cede & Co. is the registered owner of the Bonds, principal of and interest on the Bonds are payable by wire transfer by the Registrar to DTC, which in turn is obligated to remit such principal and interest to the DTC participants for subsequent disbursements to Beneficial Owners of the Bonds. See APPENDIX D—"BOOK-ENTRY SYSTEM."

Termination of Book-Entry Transfer System

If DTC or its successor resigns as the securities depository or if the District determines that it is no longer in the best interests of owners of beneficial interests in the Bonds to continue the system of book-entry transfers through DTC or its successor, the District will deliver at no cost to the Beneficial Owners of the Bonds or their nominees Bonds in registered certificate form, in the denomination of \$5,000 or any integral multiple thereof within a single maturity. Thereafter, the principal of the Bonds will be payable upon due presentment and surrender thereof at the principal office of the Paying Agent. Interest on the Bonds will be payable by check or draft mailed on the interest payment

date to the persons in whose names the Bonds are registered, at the address appearing upon the Bond Register on the 15th day of the month prior to such interest payment date or, at the request of the owner of \$1,000,000 or more in aggregate principal amount of Bonds, by wire transfer to a bank within the United States.

Transfer and Exchange

As long as DTC (or a successor or substitute depository) is not the registered owner of the Bonds, any Bond may be transferred at the principal office for such purpose of the Registrar by surrender of such Bond for cancellation, accompanied by a written instrument of transfer, in form satisfactory to the Registrar, duly executed by the registered owner in person or by his/her duly authorized attorney, and thereupon the District will issue and the Registrar will authenticate and deliver at the principal office of the Registrar (or send by registered or first class insured mail to the owner at the owner's expense), in the name of the transferee or transferees, a new Bond or Bonds of the same interest rate, aggregate principal amount, series and maturity, and on which interest accrues from the last interest payment date to which interest has been paid so that there shall result no gain or loss of interest as a result of such transfer, upon payment of any applicable tax or governmental charge.

Optional Redemption

The District reserves the right and option to redeem the Bonds prior to their stated maturity dates at any time on or after July 1, 2023, as a whole or in part (within one or more maturities selected by the District), at par plus accrued interest to the date fixed for redemption.

Mandatory Redemption

The Bonds maturing on January 1, 2038 and January 1, 2041 (which are Term Bonds) shall be redeemed prior to maturity (or paid at maturity), no later than January 1 in the years and in the sinking fund installment amounts set forth below (to the extent such Bonds have not been previously redeemed or purchased), by payment of the principal amount thereof, together with the interest accrued thereon to the date fixed for redemption.

2038 Term Bonds

Year	Sinking Fund Installment
2034	\$ 3,915,000
2035	4,110,000
2036	4,315,000
2037	4,535,000
2038*	4,760,000

* Maturity.

2041 Term Bonds

Year	Sinking Fund Installment
2039	\$ 4,995,000
2040	5,245,000
2041*	5,510,000

* Maturity.

Partial Redemption

If less than all of the Bonds are to be redeemed, the District may select the maturity or maturities to be redeemed. If less than all of the Bonds of any maturity are to be redeemed, the Bonds or portions thereof to be redeemed are to be selected by the Registrar or DTC, as applicable, randomly, or in accordance with their respective standard procedures. The Bond Resolution provides that the portion of any Bonds of a denomination of more than \$5,000 to be redeemed will be in the principal amount of \$5,000 or any integral multiple thereof and that in selecting portions of such Bonds for redemption, the Registrar will treat each such Bonds as representing that number of such Bonds of \$5,000 denomination that is obtained by dividing the principal amount of such Bonds to be redeemed in part by \$5,000.

Notice of Redemption

So long as the Bonds are held by DTC in book-entry only form, any notice of redemption will be given at the time, to the entity and in the manner required by the Blanket Issuer Letter of Representations between the District and DTC (“Letter of Representations”). During any period in which the Bonds are not in book-entry only form, unless waived by any registered owner of the Bonds to be redeemed, official notice of any redemption of Bonds will be given by the Bond Registrar on behalf of the District by mailing a copy of an official redemption notice by first-class mail, postage prepaid, at least 20 days and not more than 60 days prior to the date fixed for redemption, to the registered owners of the Bonds to be redeemed at the address appearing on the bond register at the time the Bond Registrar prepares the notice.

In the case of an optional redemption, the District reserves the right to rescind any redemption notice and the related optional redemption of Bonds by giving a notice of rescission to the affected registered owners at any time on or prior to the scheduled optional redemption date. Any notice of optional redemption that is so rescinded will be of no effect, and the Bonds for which the notice of optional redemption has been rescinded will remain outstanding.

Interest on the Bonds called for redemption will cease to accrue on the date fixed for redemption, except in the case of a rescinded optional redemption as described above or unless payment of that Bond is not made or provided for in full on the date fixed for redemption.

Open Market Purchases

The District has reserved the right to purchase Bonds in the open market in an amount and at such price as the District shall determine.

Defeasance of the Bonds

The District may set aside with a trustee or escrow agent in a special trust account irrevocably pledged to the payment of certain Bonds, cash, Government Obligations and/or Refunded Municipals, if permitted by law, sufficient, together with the earnings thereon, to provide funds to pay when due the interest on part or all of the Bonds and to redeem and retire such Bonds at or prior to maturity in accordance with their terms. Prior to any defeasance, the District must obtain a verification from an independent certified public accountant that the escrowed cash and securities are sufficient to pay the Bonds and an opinion of nationally-recognized bond counsel that such defeasance will not cause interest on any tax-exempt Parity Bonds then outstanding to become subject to federal income taxes. In such event no further payment need be made into the Bond Fund for the payment of the principal of and interest on the Bonds so provided for and such Bonds shall cease to be entitled to any lien, benefit or security of the Bond Resolutions except the right to receive payment from such special account, and such Bonds shall not be deemed to be outstanding for purposes of the Bond Resolution.

The term “Government Obligations” has the meaning given in chapter 39.53 RCW, as amended, currently: (i) direct obligations of, or obligations the principal of and interest on which are unconditionally guaranteed by the United States of America and bank certificates of deposit secured by such obligations; (ii) bonds, debentures, notes, participation certificates, or other obligations issued by the Banks for Cooperatives, the Federal Intermediate Credit Bank, the Federal Home Loan Bank System, the Export-Import Bank of the United States, Federal Land Banks, or the Federal National Mortgage Association; (iii) public housing bonds and project notes fully secured by contracts with the United States; and (iv) obligations of financial institutions insured by the Federal Deposit Insurance Corporation or the Federal Savings and Loan Insurance Corporation, to the extent insured or to the extent guaranteed as permitted under any other provision of State law.

SECURITY FOR THE PARITY BONDS

Pledge of Revenues

The Bonds and the interest thereon are payable solely from the Electric System Revenue Bond Fund (the “Bond Fund”) created by Resolution No. 4744 of the District. The District has covenanted: (i) to pay into the Revenue

Fund created by Resolution No. 75 all Gross Revenue, except for certain investment income, and (ii) to pay into the Bond Fund amounts sufficient to pay the principal of, premium, if any, and interest on all Parity Bonds outstanding as the same become due and payable and to provide the required payments into the Reserve Fund. The pledge of the Gross Revenue is subject to its prior application for payment of Operating Expenses and costs associated with Resource Obligations for any month in which any power and energy or other goods and services from such resources were made available to the Electric System. The District has covenanted in the Bond Resolution not to issue any obligations subsequent to the issuance of the Bonds with a lien or charge on the Gross Revenue of the Electric System prior to the lien and charge of the Parity Bonds. See “SECURITY FOR THE PARITY BONDS—Electric System Obligation for the Priest Rapids Project Bonds.”

The rights of the owners of the Bonds under the Bonds and the Bond Resolution, and the enforceability thereof, may be subject to judicial discretion and valid exercise of sovereign police powers of the State of Washington, and of the Constitutional powers of the United States of America, and valid bankruptcy, insolvency, receivership, reorganization, moratorium, and other laws affecting creditors’ rights.

Limited Obligations

The Bonds are special limited obligations of the District and are not obligations of the State of Washington or any political subdivision thereof other than the District, and neither the full faith and credit nor the taxing power of the District nor the revenues of any utility systems of the District other than the Gross Revenue of the Electric System are pledged to the payment of the Bonds.

Rate Covenant

The District has covenanted to establish, maintain and collect rates or charges for electric energy and other services, commodities and facilities sold, furnished or supplied by the District in connection with the operation of the Electric System which shall be fair and non-discriminatory and sufficient to provide Net Revenue in any Fiscal Year hereafter equal to at least 1.25 times the Annual Debt Service in such Fiscal Year on outstanding Parity Bonds, excluding any capitalized interest thereon in such Fiscal Year. For purposes of calculating the coverage requirement, there must be added to the Net Revenue in any year any amount withdrawn from the Rate Stabilization Account in such calendar year and deposited in the Revenue Fund, and there must be subtracted from Net Revenue in any year any amount withdrawn from the Revenue Fund and deposited in the Rate Stabilization Account. See APPENDIX A—“SUMMARY OF CERTAIN PROVISIONS OF THE BOND RESOLUTION—Rate Stabilization Account.”

Additional Bonds

The District has covenanted not to issue any obligations subsequent to the issuance of the Bonds with a lien or charge on the Gross Revenue of the Electric System prior to the lien and charge of the Bonds and the 2011 Bonds. The Bond Resolution permits the issuance of junior lien debt. The District, subject to the limitations set forth in the Bond Resolution, may for any lawful purpose of the District issue bonds having a lien upon the Gross Revenue of the Electric System (subject to prior application for the payment of Operating Expenses and, in certain circumstances, Resource Obligations) equal to the lien of the Parity Bonds if, among other things, a certificate of the District sets forth that the Net Revenues for any 12 consecutive months of the 24 months prior to the date of issuance of such Bonds, divided by the maximum Annual Debt Service in any future fiscal year for all Parity Bonds then outstanding and Additional Bonds then to be issued, results in a percentage that is not less than 125%. For the purpose of this certificate, Net Revenue may be adjusted to include a full 12 months of net revenue from any customers added during the 12-month period being considered; the annual estimated net revenue to be received as a result of any additions, betterments and improvements to and extensions of the Electric System to be acquired, constructed or installed by the District from the proceeds of the Future Parity Bonds to be issued or under construction at the time of such certificate; and the additional net revenue which would have been received by the District if any rate change adopted prior to the delivery of the Future Parity Bonds, but subsequent to the beginning of the 12-month period being considered, had been in force during the full 12-month period. In the alternative, the District may obtain a certificate from a Professional Utility Consultant stating that the projected annual Net Revenue for the Fiscal Years in which the Parity Bonds, including the Future Parity Bonds being issued, will be outstanding are expected to at least equal 1.25 times the Annual Debt Service required to be paid in any Fiscal Year thereafter.

See APPENDIX A—“SUMMARY OF CERTAIN PROVISIONS OF THE BOND RESOLUTION—Additional Bonds.”

Flow of Funds Under the Bond Resolution

The District has covenanted that so long as any of the Parity Bonds are outstanding and unpaid it will continue to pay into the Revenue Fund all Gross Revenue exclusive of earnings on money in any arbitrage rebate account, the Reserve and Contingency Fund or the Reserve Fund, which may be retained in such funds and account.

The Gross Revenue of the District shall be used only for the following purposes and in the following order of priority:

- (1) to pay Operating Expenses and costs associated with Resource Obligations (to the extent payable as Operating Expenses);
- (2) to make all payments required to be made into the Bond Fund for the payment of accrued interest on the next interest payment date and to make any District Payments (See APPENDIX A—“SUMMARY OF CERTAIN PROVISIONS OF THE BOND RESOLUTION—Derivative Products”);
- (3) to make all payments required to be made into the Bond Fund for the payment of the principal amount of Serial Bonds next coming due, and into the Bond Fund for the optional or mandatory redemption of Term Bonds;
- (4) to make all payments required to be made into the Reserve Fund, or to meet a reimbursement obligation with respect to any Qualified Insurance or Qualified Letter of Credit or other credit enhancement device, if so required by resolution of the Commission; and
- (5) to make all payments required to be made into any special fund or account created to pay or secure the payment of the principal of and interest on any revenue bonds, warrants or other revenue obligations of the District having a lien upon Gross Revenue and money in the Revenue Fund and Bond Fund and accounts therein junior and inferior to the lien thereon for the payment of the principal of and interest on the Parity Bonds.

Costs associated with Resource Obligations not payable as Operating Expenses shall be paid on a parity with outstanding Parity Bonds as provided in Sections (2) and (3) above.

After all of the above payments and credits have been made, amounts remaining in the Revenue Fund may be used for any other lawful purpose of the District.

Electric System Obligation for the Priest Rapids Project Bonds

As of June 1, 2013, the District had outstanding \$901,330,000 principal amount of bonds for the Priest Rapids Project. In addition, the District issued \$100,070,000 of Priest Rapids Hydroelectric Project Revenue Bonds, Series 2013A and Series 2013Z (Taxable) (the “2013 Priest Rapids Project Bonds”), on August 29, 2013. The District has covenanted (1) to pay to the Priest Rapids Project from the Electric System that portion of the annual costs of the Priest Rapids Project for such Fiscal Year, including without limitation for operating and maintenance expenses and debt service on the Priest Rapids Project Bonds, that is not otherwise paid or provided for from payments received by the Priest Rapids Project from the sale of power and energy and related products from the Priest Rapids Project to purchasers other than the District and (2) to establish, maintain and collect rates and charges for electric power and energy and related products sold through the Electric System sufficient to make any such payments to the Priest Rapids Project.

Payments made by the Electric System for its share of the output of the Priest Rapids Project and other costs of purchased power and energy from the Priest Rapids Project are Operating Expenses of the Electric System, and,

therefore, are payable prior to debt service on the Parity Bonds (as long as power or energy is produced or capable of being produced). The obligation of the Electric System to pay for all other costs associated with the Priest Rapids Project, (including debt service if power or energy is not produced or capable of being produced) is junior in rank to all other obligations of the Electric System. See "THE PRIEST RAPIDS PROJECT." For a summary of outstanding debt of the District, see Table 8.

Reserve Fund

2013 Reserve Fund

The Bond Resolution created a new reserve fund for the 2013 Bonds (the "Reserve Fund"). The Reserve Fund Requirement with respect to the Bonds and any Future Parity Bonds secured by the Reserve Fund shall be an amount equal to the lesser of (a) 125% of average Annual Debt Service or (b) maximum Annual Debt Service, and that at the time of issuance of any series of bonds, the Reserve Fund Requirement allocable to a series of Parity Bonds shall not exceed 10% of the initial principal amount of that series of Parity Bonds. Such Reserve Fund Requirement may be recalculated and determined from time to time.

The District will fund the Reserve Fund Requirement for the Bonds on the date of issuance of the Bonds with Bond proceeds. The Reserve Fund will be held by the District.

The resolution authorizing Future Parity Bonds may establish a separate Reserve Fund for such Future Parity Bonds or provide that such Future Parity Bonds be secured by a common Reserve Fund. The reserve fund requirement may be recalculated as of the date of the defeasance of any Parity Bonds. If the interest rate on any such Parity Bonds is other than a fixed rate, interest on such Parity Bonds is calculated as provided in the Bond Resolution. The valuation of the amount in the Reserve Fund must be made by the District on each December 31 and may be made on each June 30. Such valuation shall be at the market value thereof (including accrued interest) for obligations maturing more than six months from the valuation date or at par for obligations maturing within six months of the valuation date.

The Reserve Fund Requirements for Future Parity Bonds may be funded either from Parity Bond proceeds or from Gross Revenues over a five-year period following the date of issuance. As an alternative, the District may fund all or a portion of the Reserve Fund through the purchase of Qualified Insurance or a Qualified Letter of Credit. See "Certain Definitions" and "Bond Fund" in APPENDIX A—"SUMMARY OF CERTAIN PROVISIONS OF THE BOND RESOLUTION" relating to the satisfaction of the Reserve Fund Requirement through the deposit of a letter of credit or insurance policy.

The District has covenanted to make up any deficiency in the Bond Fund from the funds available in the Reserve Fund. The District will replenish such withdrawals from money in the Revenue Fund first available after making current specified payments into the Bond Fund, and after paying and making provision for the payment of Operating Expenses.

The owners of the Bonds and the 2011 Bonds by taking and holding the same shall be deemed to have consented to the adoption by the District of any Supplemental Resolution amendatory to the Bond Resolution to provide that Qualified Insurance or Qualified Letter of Credit may be obtained if the provider is rated in one of the two highest categories by Moody's or S&P or their comparable recognized business successors or both Moody's or S&P at the time the letter of credit or insurance is obtained.

Money in the Bond Fund may, at the option of the District, be invested and reinvested as permitted by law in Permitted Investments maturing, or which are retireable at the option of the owner, prior to the date needed or prior to the maturity date of the final installment of principal of the Parity Bonds payable out of the Bond Fund. Earnings on investments in the Bond Fund shall be transferred to the Revenue Fund, except that earnings on investments in the Reserve Fund shall first be applied to remedy any deficiency in such account.

2011 Reserve Fund

As provided in Resolution No. 8572 (the “2011 Bond Resolution”), the resolution authorizing the issuance of the 2011 Bonds, the reserve fund requirement with respect to the 2011 Bonds and Future Parity Bonds secured by the 2011 Reserve Fund (the “2011 Reserve Fund Requirement”) was an amount equal to the lesser of (a) 125% of average Annual Debt Service or (b) maximum Annual Debt Service, and that at the time of issuance of the 2011 Bonds, the 2011 Reserve Fund Requirement did not exceed 10% of the initial principal amount of the 2011 Bonds. Such 2011 Reserve Fund Requirement may be recalculated and determined from time to time.

To meet the 2011 Reserve Fund Requirement, the District holds a reserve account surety policy issued by Financial Security Assurance Inc., which is now known as Assured Guaranty Municipal Corp. (“Assured”), in the amount of \$6,491,726. Moody’s Investors Service (“Moody’s”) and Standard & Poor’s Ratings Services (“S&P”) currently rate Assured “A2” and “AA-,” respectively. The surety policy terminates when the portion of the 2011 Bonds that refunded prior bonds of the District are no longer outstanding, which is expected to be on January 1, 2019. In addition, as of June 1, 2013, there was \$11,378,129 in the 2011 Reserve Fund. The 2011 Reserve Fund is not available to pay the Bonds.

The District has covenanted to make up any deficiency in the Bond Fund with respect to the 2011 Bonds from the funds available in the 2011 Reserve Fund. The District will replenish such withdrawals from money in the Revenue Fund first available after making current specified payments into the Bond Fund, and after paying and making provision for the payment of Operating Expenses. Once the surety policy is terminated (expected to be in 2019), and if the 2011 Bonds are the only Parity Bonds secured by the Reserve Fund, the District shall not be required to replenish any deficiency in the 2011 Reserve Fund as the result of such termination.

Reserve and Contingency Fund

The District has established an Electric System Reserve and Contingency Fund (the “R&C Fund”) for the purposes of paying the costs of extraordinary, unexpected or catastrophic expenses not otherwise provided for, additional power and energy purchases, and defeasing outstanding debt. The Commission determines the amount, if any, to deposit in such fund as part of the annual budget. The R&C Fund is pledged to the payment of the Bonds to the extent, if any, of money in such fund. There was approximately \$71.5 million in the R&C Fund as of June 1, 2013. Continued maintenance of the R&C Fund is within the discretion of the Commission. The Rate Stabilization Account is an account within the R&C Fund. See APPENDIX A—“SUMMARY OF CERTAIN PROVISIONS OF THE BOND RESOLUTION—Rate Stabilization Account” for a discussion of the use of the Rate Stabilization Account for rate stabilization purposes.

Resource Obligations; Take or Pay Contracts

Upon compliance with certain requirements in the Bond Resolution (See APPENDIX A—“SUMMARY OF CERTAIN PROVISIONS OF THE BOND RESOLUTION—Separate System Bonds; Resource Obligations”), the District may (1) enter into contracts for the purchase of energy, capacity, capability, reserves, conservation or services or (2) construct or acquire as a separate system, facilities or resources for the generation of power and energy or for the conservation, transformation, transmission or distribution of power and energy and may declare costs associated with such contract or separate system (including debt service on bonds) to be a resource obligation (“Resource Obligation”) of the Electric System to be paid as an Operating Expense of the Electric System for any month in which power and energy or other goods and services from such resource were made available to the Electric System during such month (regardless of whether or not the Electric System actually scheduled or received energy from such resource during such month). At all other times a Resource Obligation is an indebtedness of the Electric System payable from Gross Revenue on a parity of lien with the Bonds. The District has not entered into Resource Obligations. The District’s share of the Priest Rapids Project is not a Resource Obligation, but the District’s costs associated with the Priest Rapids Project are Operating Expenses as long as power or energy is provided or capable of being provided.

The District has covenanted in the Bond Resolution not to enter into any agreement which obligates the District to pay from Gross Revenue for (a) generating or transmission capacity or energy or the use or lease of generating or transmission facilities (under which agreement payment is not conditioned on the availability of such capacity,

energy or facility) or (b) the installment purchase or lease of property which otherwise transfers to the District the burdens and benefits of ownership, unless such agreement specifically provides that the payment obligation of the District thereunder is junior to the obligation of the District to make payments from the Revenue Fund into the Bond Fund. This restriction does not apply to Resource Obligations or any agreement relating to the Priest Rapids Project or to any other hydroelectric facility owned and operated by the District.

Other Covenants

The District has, among other covenants, made covenants in the Bond Resolution with respect to maintenance of District properties, sale or disposition of the Electric System, insurance and the keeping of proper books of account of the Electric System. See APPENDIX A—“SUMMARY OF CERTAIN PROVISIONS OF THE BOND RESOLUTION—Additional Covenants.”

Derivative Products

To the extent permitted by State law, the District may enter into Derivative Products secured by a pledge and lien on Gross Revenue on a parity with the Bonds and the 2011 Bonds subject to the satisfaction of certain conditions precedent. A “Derivative Product” is a written contract between the District and a third party obligating the District to make District Payments (subject to certain conditions) on one or more scheduled and specified payment dates in exchange for a Reciprocal Payor’s obligation to pay or cause to be paid Reciprocal Payments to the District on scheduled and specified payment dates. Derivative Products include agreements providing for an exchange of payments based on interest rates (known as interest rate swaps) or providing for ceilings or floors on such payments. For a definition of terms used in this paragraph and a summary of the conditions precedent to the District’s entering into a Derivative Product, see APPENDIX A—“SUMMARY OF CERTAIN PROVISIONS OF THE BOND RESOLUTION—Derivative Products.” See “THE ELECTRIC SYSTEM—Power Supply Management and Power Marketing” for a description of two power supply derivative products.

No Acceleration Upon Default

Upon the occurrence and continuance of an Event of Default under the Bond Resolution, payment of the principal amount of the Bonds is not subject to acceleration. The District thus would be liable only for principal and interest payments as they became due, and the bondowners would be required to seek a separate judgment for each payment, if any, not made. Any such action for money damages would be subject to any limitations on legal claims and remedies against public bodies under Washington law. Amounts recovered would be applied to unpaid installments of interest prior to being applied to unpaid principal and premium, if any, which had become due. The bonds issued for the Priest Rapids Project also are not subject to acceleration. The District has never defaulted in the payment of principal or interest on any of its bonds.

Debt Service Requirements for the Electric System

The District's debt service requirements on the Bonds and the 2011 Bonds are as follows. The District's debt service requirements for the outstanding Priest Rapids Project bonds are shown in Table 18.

Table 1
DEBT SERVICE REQUIREMENTS OF THE ELECTRIC SYSTEM (1)

Year (2)	Outstanding Parity Bonds Debt Service	The Bonds		Total Debt Service
		Principal	Interest	
2014	\$ 9,494,006	--	\$ 967,413	\$ 10,461,419
2015	4,726,831	--	3,381,250	8,108,081
2016	3,762,581	--	3,381,250	7,143,831
2017	3,762,581	--	3,381,250	7,143,831
2018	3,762,581	--	3,381,250	7,143,831
2019	17,819,706	--	3,381,250	21,200,956
2020	17,805,081	--	3,381,250	21,186,331
2021	17,786,706	--	3,381,250	21,167,956
2022	17,770,681	--	3,381,250	21,151,931
2023	15,470,641	--	3,381,250	18,851,891
2024	--	\$2,405,000	3,381,250	5,786,250
2025	--	2,525,000	3,261,000	5,786,000
2026	--	2,650,000	3,134,750	5,784,750
2027	--	2,785,000	3,002,250	5,787,250
2028	--	2,920,000	2,863,000	5,783,000
2029	--	3,070,000	2,717,000	5,787,000
2030	--	3,220,000	2,563,500	5,783,500
2031	--	3,385,000	2,402,500	5,787,500
2032	--	3,550,000	2,233,250	5,783,250
2033	--	3,730,000	2,055,750	5,785,750
2034	--	3,915,000	1,869,250	5,784,250
2035	--	4,110,000	1,673,500	5,783,500
2036	--	4,315,000	1,468,000	5,783,000
2037	--	4,535,000	1,252,250	5,787,250
2038	--	4,760,000	1,025,500	5,785,500
2039	--	4,995,000	787,500	5,782,500
2040	--	5,245,000	537,750	5,782,750
2041	--	5,510,000	275,500	5,785,500
	<u>\$112,161,395</u>	<u>\$67,625,000</u>	<u>\$67,902,163</u>	<u>\$247,688,558</u>

(1) Excludes the Refunded Bonds.

(2) Based on a calendar year, including January 1 and July 1 payments made in that year. Certain columns may not add due to rounding.

Future Electric System Borrowings

The District currently does not expect to issue additional Parity Bonds in the next two years.

THE DISTRICT

General

The District is a Washington State municipal corporation. It was organized in 1938 pursuant to a general election in accordance with the Enabling Act and commenced operations in 1942. The District has its administrative offices in

Ephrata, Washington, the county seat of Grant County (the “County”), which is located in central Washington. The District’s Electric System serves all of the County.

Pursuant to Washington State statutes, the District is administered by a Board of Commissioners (the “Commission”) of five elected members. The legal responsibilities and powers of the District, including the establishment of rates and charges for services rendered, are exercised through the Commission. The Commission establishes policy, approves plans, budgets and expenditures and reviews the District’s operations.

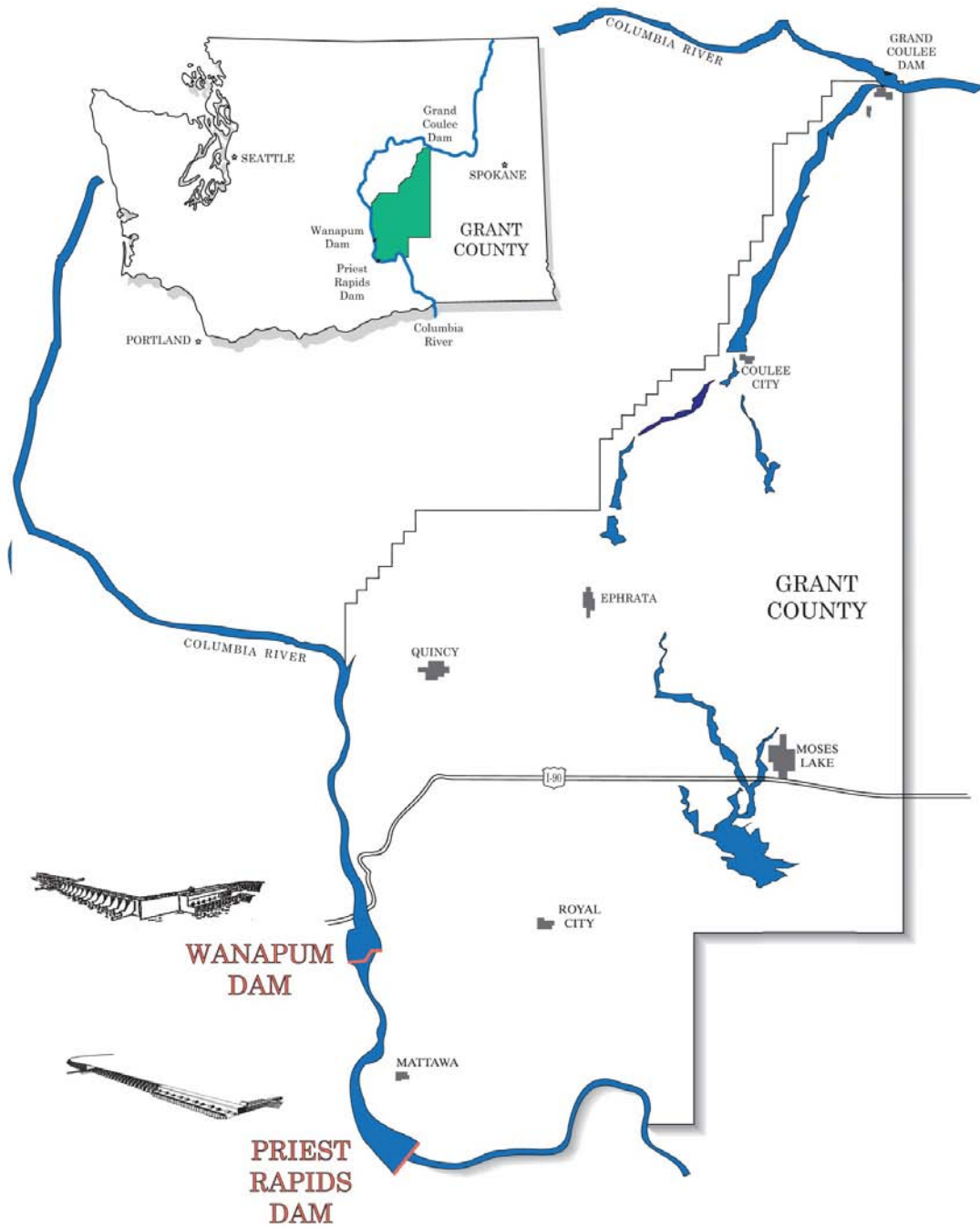
The District’s electric utility properties and operations consist of two operating systems, each of which is accounted for and financed separately. The systems are the Electric System and the Priest Rapids Project, which consists of the Priest Rapids Development and the Wanapum Development. The present combined total nameplate generating capacity of the Priest Rapids Project is approximately 2,048 megawatts (“MW”). The revenues of the Priest Rapids Project are not pledged to or available for the payment of the bonds of the Electric System. See “THE ELECTRIC SYSTEM” and “THE PRIEST RAPIDS PROJECT.”

Although cities in the District’s service area have statutory authority to provide electric service, only the town of Coulee Dam, which is located partially in Grant County, has its own electric distribution system. The District is not aware of any other city that is considering providing electric service. The District also has statutory rights of eminent domain which, subject to certain limitations, enable the District to acquire various assets and property rights, including electric distribution facilities in Grant County of any investor-owned utility company that may seek to serve Grant County. The District’s facilities in any city and its right to provide electric service in any city are subject to the reasonable police power of such city.

Under Washington law, public utility districts (such as the District) are authorized to provide retail electrical service beyond their boundaries. Further, investor-owned utilities are not prohibited from providing retail electrical service beyond their current service area.

The following map shows the District’s service area and location of the Priest Rapids and Wanapum Developments.

ELECTRIC SYSTEM RETAIL SERVICE AREA



Management and Administration

The Commissioners of the District, their titles and the expiration of their respective terms of office are listed below.

Name	Title	Expiration of Term of Office (12/31)
Terry Brewer	President	2018
Bob Bernd	Vice President	2014
Dale Walker	Secretary	2016
Thomas Flint	Commissioner	2016
Larry Schaapman	Commissioner	2014

Terry Brewer, President, joined the Commission in 2007. He has over 30 years of experience in the electric utility industry. Commissioner Brewer recently retired as Executive Director of the Grant County Economic Development Council. He is a board member of Energy Northwest and the North Central Workforce Development Council and is President-elect of the Ephrata Rotary Club. Commissioner Brewer graduated from Indiana University with a business degree.

Bob Bernd, Vice President, joined the Commission in 2007. A Grant County native, Commissioner Bernd is retired from a career in moving and storage, waste disposal and recycling. He served 26 years on the Moses Lake Planning Commission, is a board member and former chair for the Boys and Girls Club of the Columbia Basin, former board member and chair of the Grant County Housing Authority and past president and member of the Moses Lake Lions Club. He is a graduate of Washington State University and holds a degree in business management.

Dale Walker, Secretary, joined the Commission in 2011. He is a 57-year resident of Grant County, having been actively involved in agriculture and agriculture research. Commissioner Walker has served local, state and national organizations representing the agricultural industry. His family was involved in the development of the Columbia Basin Project.

Thomas Flint, Commissioner, joined the Commission in 2001. He is a fifth generation farmer actively farming in Grant County. Commissioner Flint serves as a director on the AgFarmation Project and the Blacksands Irrigation District. He is a past president of the Washington Public Utility Districts Association. Commissioner Flint is a graduate of Central Washington University and holds a degree in industrial technology.

Larry Schaapman, Commissioner, joined the Commission in 2012 and was appointed to fill the position of a retiring Commissioner. He has been a resident of Grant County for 40 years and has operated several businesses. He owns and operates a family farm and is on the Potato Growers of Washington Board and Sun Basin/CHS board of directors.

The senior management team of the District is as follows:

Anthony Webb, General Manager, has been with the District since 1990 and General Manager since February 2013. He previously served as Assistant General Manager and Director of Customer Service and Director of Human Resources and Support Services for the District. Mr. Webb has a Bachelor of Arts degree from Eastern Washington University and experience in aerospace industrial engineering management.

Chuck Berrie, Assistant General Manager, joined the District in 2007. A Grant County native, Mr. Berrie has more than 27 years of utility experience at three eastern Washington public utility districts. Prior to joining the District, he served as general manager of the Public Utility District No. 1 of Okanogan County. He presently manages the District's hydro and natural resources divisions. Mr. Berrie has a Bachelor of Science degree from Washington State University.

Kevin Nordt, Chief Financial Officer, joined the District in 2004 and has nearly 20 years of experience in the Northwest energy market. In addition to his role as CFO, Mr. Nordt manages the support services and power management divisions. He has a Bachelor of Science degree from St. John's University, a Master of Science degree

from the University of Wisconsin and additional graduate work in computational finance at Oregon Graduate Institute.

Mitch Delabarre, General Counsel, joined the District in 2009. He has more than 24 years of legal experience, including 18 years working with municipal organizations in Grant County. Mr. Delabarre holds a Bachelor of Science degree from San Diego State University and obtained his law degree from Willamette University College of Law.

Jeff Grizzel, Director of Natural Resources, joined the District in 2010 after 16 years with the Washington State Department of Natural Resources. His work with the State included land use policy development and watershed analysis implementation aimed at protecting salmon habitat. Mr. Grizzel holds a Master of Science degree from Oregon State University.

Debbie Lowe, Director of Support Services, has been with the District since 1984. She manages the support services and information technology functions for the utility and previously served as the District's Customer Service Manager.

Mike McClenahan, Director of Power Management, joined the District in 2012. He has 25 years of energy industry experience. During that time, he has worked in a range of areas including power plant and transmission system operations, regulatory policy and practice, long-term power contracting, short term trading, risk management, market analysis, business development and reliability. He has worked for a variety of organizations including regulated utilities, independent power producers, service providers and public power.

Andrew Munro, Director of Customer Service, joined the District in 2007. He has 20 years of electric industry management and government relations experience, including half of those years in public power. His responsibilities include transmission and distribution engineering, line department, electric shop, customer service and telecom/fiber-optic network. Mr. Munro holds a Bachelors of Arts degree from the University of Washington.

Bonnie Overfield, Director of Finance, has been with the District since 2004. Her experience and responsibilities center on financial and strategic planning, accounting, risk management and economic analyses. Ms. Overfield holds a Bachelor of Arts degree from Eastern Washington University and a Master of Business Administration degree.

Dawn Woodward, Director of Hydro, has been with the District since 1981 and has served as the Director of Hydro since 2005. She has extensive experience throughout the utility's operations and previously served as the Director of Customer Service, Support Services and Human Resources. Ms. Woodward has represented the District in a wide variety of civic organizations throughout the County.

Accounting and Financial Statements

The accounting and reporting policies of the District conform to generally accepted accounting principles for municipal governments and are regulated by the Washington State Auditor's Office. The State Auditor's Office has the responsibility to audit the District's financial operations. In addition, the District's financial statements are audited by an independent auditing firm. The District's current independent auditor is PricewaterhouseCoopers LLP, which has been the District's auditor since 2003. The audited financial statements of the District for the fiscal years ended December 31, 2012 and 2011 are included as a part of this Official Statement as Appendix B.

District Employees

Following are the number of District employees by function as of June 6, 2013.

Function	Number of Regular Employees (Full Time)
Manager's Division	8
Power Management	36
HR/Safety	13
Accounting, Finance and Strategic Planning	21
Hydro Generation	231
Natural Resources	41
Support Services	98
Customer Service	179
Reliability and Compliance	3
Total	630

The District also has approximately 22 full-time equivalent part-time and temporary employees. In addition to its regular staff, the District employs a number of employees by contract for transmission and distribution line construction work, pole-testing and tree-trimming, turbine and generator rehabilitation, and environmental and other projects.

Of the 630 regular employees, as of June 6, 2013, 58% are bargaining unit employees under a Collective Bargaining Agreement ("CBA") with the International Brotherhood of Electric Workers (the "IBEW"). The current IBEW three-year CBA runs through March 31, 2014. There has not been a significant labor stoppage at the District since 1978.

Pensions

Pensions for the District's employees are provided by the Washington State Public Employees Retirement System ("PERS") through three different retirement plan options. These plans are administered by the State. The Washington State Investment Board invests the funds in the plans. PERS Plan 1 and Plan 2 are defined benefit plans. PERS Plan 3 is both a defined benefit plan (employer share) and defined contribution plan (employee share). Contributions by both employees and employers are based on gross wages. PERS participants who joined the system by September 30, 1977 are Plan 1 members. Those PERS participants who joined on or after October 1, 1977 are Plan 2 members, unless they exercise an option to transfer to Plan 3. PERS participants joining on or after September 1, 2002 have the irrevocable option of choosing membership in PERS Plan 2 or PERS Plan 3.

State law requires systematic actuarial funding to finance the retirement plans. Actuarial calculations to determine employer and employee contributions are prepared by the Office of the State Actuary ("OSA"), a nonpartisan legislative agency charged with advising the Legislature and Governor on pension benefits and funding policy. To calculate employer and employee contribution rates necessary to pre-fund the plans' benefits, OSA uses actuarial cost and asset valuation methods selected by the Legislature as well as economic and demographic assumptions. The Legislature adopted the following economic assumptions for contribution rates beginning July 1, 2013: (1) 7.9% rate of investment return; (2) general salary increases of 3.75%; (3) 3.0% rate of Consumer Price Index increase; and (4) 0.95% growth in membership. The long-term investment return assumption is used as the discount rate for determining the liabilities for a plan. The 10-year (2003-2012) average annual return on the investment of the retirement funds was 9.24%.

All State-administered retirement plans are funded by a combination of funding sources: (1) contributions from the State; (2) contributions from employers (including the State as employer and the District and other governmental employers); (3) contributions from employees; and (4) investment returns. Retirement funds are invested by the Washington State Investment Board, a 15-member board created by the Legislature in 1981.

Under State statute, contribution rates are adopted by the Pension Funding Council (“PFC”) in even-numbered years for the next ensuing State biennium. The rate-setting process begins with an actuarial valuation by the OSA, which makes non-binding recommendations to the Select Committee on Pension Policy which then recommends contribution rates to the PFC. No later than the end of July in even-numbered years, the PFC adopts contribution rates, which are subject to revision by the Legislature. The following table outlines the current contribution rates of employers and employees.

**Contribution Rates for the 2013-15 Biennium
Expressed as a Percentage of Covered Payroll**

	Employer ⁽²⁾	Employee
PERS Plan 1	9.21%	6.00%
PERS Plan 2	9.21	4.92
PERS Plan 3	9.21	Variable ⁽²⁾

(1) Includes a 0.18% DRS administration expense fee.

(2) Rates vary from 5.0% minimum to 15.0% maximum based on rate selected by the PERS 3 member.

Source: Department of Retirement Systems.

In 2012, the contributed \$4,268,201, on a covered payroll of \$59,313,913. The Priest Rapids Project’s and the Electric System’s shares of these costs are in proportion to their share of direct payroll costs. For additional information, see Note 8 to the Audited Financial Statements for the Years Ended December 31, 2012 and 2011, attached hereto as Appendix B.

While the District’s prior contributions represent its full current liability under the retirement systems, any unfunded pension benefit obligations could be reflected in future years as higher contribution rates. It is expected that the contribution rates for employees and employers in the PERS Plans 2 and 3 will increase in the coming years. The OSA website (which is not incorporated into this Official Statement by reference) includes information regarding the values, funding levels and investments of these retirement plans. According to the OSA, as of June 30, 2011, PERS Plans 2 and 3 had no unfunded actuarial accrued liability. However, during the years 2001 through 2010 the rates adopted by the Legislature were lower than those that would have been required to produce actuarially required contributions to PERS Plan 1, a closed plan with a large proportion of the retirees. The State Actuary’s June 30, 2011 actuarial valuation showed that the funded status of PERS Plan 1 had an unfunded accrued liability of \$3.7 billion (a 71% funded ratio on an actuarial value basis). The preliminary actuarial valuation for PERS Plan 1 as of June 30, 2012 showed a 69% funded ratio. PERS Plans 2 and 3 had a surplus of \$2.3 billion as of June 30, 2011 (a 111% funded ratio). OSA uses the Projected Unit Credit (“PUC”) cost method and the Actuarial Value of Assets (“AVA”) to report a plan’s funded status. PUC is one of several acceptable measures of a plan’s funded status under current GASB rules. The PUC cost method projects future benefits under the plan, using salary growth and other assumptions and applies the service that has been earned as of the valuation date to determine accrued liabilities. The Actuarial Value of Assets (“AVA”) is calculated using a methodology which smoothes the effect of short-term volatility in the Market Value of Assets (“MVA”) by deferring a portion of annual investment gains or losses over a period of up to eight years.

Assets for one plan may not be used to fund benefits for another plan: however, all employers in PERS are required to make contributions at a rate (percentage of payroll) determined by the OSA every two years for the sole purpose of amortizing the PERS Plan 1 unfunded actuarial accrued liability within a rolling 10-year period. The Legislature has established certain maximum contribution rates that began in 2009 and will continue until 2015 and certain minimum contribution rates that are to become effective in 2015 and remain in effect until the actuarial value of assets in PERS Plan 1 equals 100% of the actuarial accrued liability of PERS Plan 1. These rates are subject to change by future legislation enacted by the State Legislature to address future changes in actuarial and economic assumptions and investment performance. In 2011, the Legislature ended the future automatic annual increase, which is a fixed dollar amount multiplied by the member’s total years of service, for most retirees in the PERS Plan 1 plan, which is forecast to reduce the unfunded accrued actuarial liability in PERS Plan 1. A lawsuit has been filed challenging this legislation.

Other Post-Employment Benefits

The District administers a single-employer defined benefit premium program that covers a portion of healthcare insurance for retirees ages 59 1/2 to 65 and their spouses. For the years ended December 31, 2012 and 2011, the District paid \$286,000 and \$294,000 in retiree subsidies. The District's net accrued other post-employment benefit obligation at the year ended December 31, 2012 was \$1,240,000. See Note 9 to the Audited Financial Statements for the Years Ended December 31, 2012 and 2011, attached hereto as Appendix B.

Insurance

The District carries excess liability coverage with an annual aggregate limit of \$60 million with a self-insured retention of \$500,000 per occurrence. It carries underlying liability policies for specific loss types such as foreign travel and non-owned aviation liability to protect the District from losses associated with these risks. The District has established an insurance reserve fund at a minimum balance of \$1 million and a maximum of \$1.5 million to cover the self-insured portion of liability losses. The insurance reserve fund had a balance of \$1.1 million at 2012 year end. The District also maintains property, boiler and machinery insurance coverage with an aggregate limit of \$200 million, protecting against significant losses at the Priest Rapids Project, the Electric System, and all of the various District real properties, with deductibles ranging from \$25,000 to \$250,000 per loss.

Strategic Planning and Financial Policies

The District operates under a strategic plan adopted in May 2011, which was updated in January 2013 and will be reviewed annually and modified as necessary by staff and the Commission. This strategic plan addresses key District issues associated with complying with the new license requirements for the Priest Rapids Project, resource management issues, operations and maintenance, capital improvements, power supply, customer service, reliability and institutional matters such as community relationships, employee development and succession planning, and legislative and external affairs. The District's financial strategy includes rate stabilization and continued assurance of meeting the District's financial obligations and goals. Financial parameters for the Electric System include 2.0 times debt service coverage, a retail operating ratio of less than or equal to 100% (internal ratio designed to target retail rates to fully recoup operational costs absent wholesale revenues), working capital minimum of \$35 million (excluding special funds), increasing the Electric System Reserve and Contingency Fund balance to \$120 million, and on average funding a minimum of 50% of capital expenditures from revenue. Financial parameters for the Priest Rapids Project include that outstanding debt shall be less than the net book value of the Priest Rapids Project, 100% debt financing of capital projects, and a debt service coverage no less than 1.15 times, which is the debt service coverage required by the bond resolutions authorizing the Outstanding Parity Bonds.

Investments

The District invests its available funds in a manner that emphasizes preserving principal, maintaining necessary liquidity, matching investment maturities to estimated cash flow requirements, and achieving maximum yield consistent with the foregoing criteria. Eligible investments include U.S. Treasury bonds, notes, bills or other obligations of the U.S. government or agencies of the U.S. government; interest bearing demand or time deposits issued by certain banks, trust companies or savings and loan associations; fully-secured repurchase agreements; banker's acceptances having a term of 180 days or less; taxable money market portfolios restricted to obligations of one year or less and issued and guaranteed by the full faith and credit of the U.S. government; and any other investments permitted to a municipality under the laws of the State of Washington. Investments generally are made so that securities can be held to maturity. The District does not derive funds for investment from reverse repurchase agreements. In addition, the District does not invest in complex and/or volatile financial products such as "inverse floaters" or structured notes. The Bond Resolution provides that money in the Bond Fund, Reserve Fund, Revenue Fund, RR&C Fund and project accounts be invested in any investments permitted under State law and the Bond Resolution. See Appendix A—"SUMMARY OF CERTAIN PROVISIONS OF THE BOND RESOLUTION—Certain Definitions."

The following summarizes the par value of the District's investments as of December 31, 2012.

District's Investments

U.S. Treasuries	\$ 162,000,000
Federal Farm Credit Bank	25,000,000
Federal Home Loan Bank	52,000,000
Fed. Nat. Mortgage Assoc.	58,965,000
Federal Home Loan Discount Note	4,500,000
Freddie Mac	15,500,000
Freddie Mac Discount Note	8,500,000
Money Market Account	56,007,732
Municipal Bonds	11,525,000
Repurchase	52,000,000
	\$ 445,997,732

For information relating to the District's investments, see Note 2 to the Audited Financial Statements for the Years Ended December 31, 2012 and 2011, attached hereto as Appendix B.

Hazardous Waste Issues

A substantial number of federal, state, and local laws and regulations regarding waste management have been enacted. Some of these laws and regulations impose strict liability on generators, transporters, storers, and disposers of hazardous wastes. Many normal activities in connection with the generation and transmission of electricity and maintenance of associated facilities generate both non-hazardous and hazardous wastes. The District has established systems to ensure compliance and control activities that fall under the purview of these environmental laws and regulations.

The District has completed a program to remove and/or control polychlorinated biphenyl ("PCB") equipment according to the guidelines in the United States Environmental Protection Agency ("EPA") regulations and to dispose of the PCBs and contaminated equipment in a timely manner at EPA approved facilities.

Security Efforts at the District

Security is an important part of District operations. The District has developed policies, procedures, and processes to ensure business continuity for critical systems that rely on a computing environment. A dedicated security manager is on staff to identify potential security risks, work with internal teams to develop and oversee implementation of protection measures, and maintain active communication with local, state and federal law enforcement. Through these efforts, the District has sustained compliance with NERC's Critical Infrastructure Protection (CIP) requirements. The District was the first utility in the nation to pass a NERC audit with no findings.

THE ELECTRIC SYSTEM

The Electric System consists of substations, transmission and distribution lines, telecommunication facilities, and associated general plant, together with a 40-year contract interest in the Potholes East Canal ("P.E.C.") Headworks Powerplant Project, a 40-year contract interest in the Quincy Chute Project and the right to receive power from a wind project. The Electric System is owned and operated by the District and serves all of Grant County. During 2012, the Electric System operated approximately 4,183 miles of lines and served approximately 46,602 retail customers. As of December 31, 2012, the District's gross investment in the Electric System was \$889 million and its net investment was \$495 million. The Electric System has established as a goal the funding of (on average) no more than 50% of capital improvements from bond proceeds, excluding generation projects. The District's Priest Rapids Project is the primary source of power for the Electric System.

Retail Energy Sales and Customers

The Electric System's gross operating revenues for 2012 totaled approximately \$214.7 million. Of this total, approximately \$143.9 million (67%) was derived from retail energy sales to an average of 46,602 customers. Sales to other utilities provided approximately \$61.8 million of revenues (29% of the total). See "Power Supply Management and Power Marketing." Of the retail customers, 76% were residential customers, providing 25% of all retail energy revenues. Retail sales are a significant portion of revenue as stated above; however, the Electric System also receives significant surplus revenue from wholesale sales related to excess generation above its load. Retail sales are projected to remain the primary revenue source as load and rates increase relative to stable projected wholesale revenues. By 2017, net wholesale revenue (net of market sales and non-Priest Rapids Project power costs) is projected to be 23% of the overall revenue stream for the Electric System. The number of retail customers, energy sales and revenues for the year ended December 31, 2012, for each major retail customer class are listed below.

Table 2
ELECTRIC SYSTEM
2012 RETAIL CUSTOMERS, ENERGY SALES AND REVENUES

Customer Class ⁽¹⁾	Average Number of Customers		Energy Sold		Revenue ⁽²⁾	
	Number	%	GWh ⁽³⁾	%	\$000	%
Residential	35,547	76.27	743.4	18.88	35,898	24.94
Commercial	6,193	13.29	457.3	11.62	18,380	12.77
Large Commercial	93	0.20	259.6	6.60	7,527	5.23
Irrigation	4,624	9.93	536.4	13.63	19,501	13.55
Industrial	25	0.05	1,933.5	49.11	61,586	42.79
Other	120	0.26	6.4	0.16	1,019	0.72
Total	46,602	100.00	3,936.6	100.00	143,911	100.00

(1) Statistics reported by class of service classification.

(2) Includes municipal taxes.

(3) Gigawatt hour equal to 1,000 megawatt hours ("MWh").

The ten largest customers, based on retail revenue of the Electric System for the 12 months ended December 31, 2012, are shown in the following table.

Table 3
ELECTRIC SYSTEM LARGEST CUSTOMERS
(Listed alphabetically)

Customer	Location	Product
Akzo Nobel Pulp & Performance Inc.	Moses Lake	Global paints, coatings and specialty chemicals
Chemi-Con Materials Corp.	Moses Lake	Process aluminum foil for capacitors
J.R. Simplot	Quincy	Vegetables processor
Lamb-Weston, Inc.	Quincy	French fried potatoes
Microsoft Corp.	Quincy	Data center
Moses Lake Industries, Inc.	Moses Lake	Manufacture highly purified raw chemical components
Norco, Inc.	Moses Lake	Liquid nitrogen, oxygen and argon
REC Solar Grade Silicon LLC	Moses Lake	Polycrystalline silicon and silane gas
SGL Automotive Carbon Fibers LLC	Moses Lake	Manufacture carbon-based products
Yahoo!	Quincy	Data center

The Electric System's ten largest customers used approximately 44% of total retail energy sold and provided approximately 38% of retail revenues in 2012. The two largest customers used approximately 25% of total retail energy sold and provided approximately 22% of retail revenues in 2012. The District's rate structure for industrial customers is designed to include the marginal cost of additional power purchases. The power sales contracts for the Priest Rapids Project (the "Power Sales Contracts") contain provisions that when coupled with the low production cost of the Priest Rapids Project mitigate the impacts to the District from loss of significant quantities of retail load.

Large industrial and manufacturing customers have continued to express interest, locate or enlarge their operations in the County throughout the economic downturn of 2007-2009 and the subsequent economic recovery. REC Solar Grade Silicon LLC ("REC") completed a large expansion to its facilities in late 2009. Since then, REC has idled its old technology plant and is focused on operating its new plant and technologies. SGL Carbon Fiber completed its first phase and began operations in 2012 with its next manufacturing line expected to begin production in late 2013. Pacific Coast Canola finished construction of its facility in late 2012 and began processing in early 2013. Microsoft recently signed an agreement that will expand its data center operations in the County with the new load expected to come online in 2014. Data center operations have been an expanding portion of District load over the last decade with Microsoft, Yahoo!, Intuit, Dell, Sabey Data Centers, and Vantage Data Centers utilizing the District's telecommunications infrastructure. See "Telecommunications" below. The District remains in discussion with several additional customers looking for new and expanded facilities within the County. The District expects an increase in Electric System load of 17% to 20% over the next five to seven years. This growth is driven primarily by load growth within the large industrial and manufacturing sector that is projected to increase by 30% to 34% over the next five to seven years. The industrial and manufacturing growth projection is based on existing signed agreements for new or expanded facilities along with some projection of existing customer growth within the District's customer base. The District believes that this growth is manageable based on the availability of resources and the structure of the District's Power Sales Contracts for the Priest Rapids Project.

The following table sets forth the customers, energy sales and revenues of the Electric System as derived from the financial statements of the Electric System for the fiscal years indicated.

Table 4
ELECTRIC SYSTEM
RETAIL CUSTOMERS, ENERGY SALES, AND REVENUES

	2008	2009	2010	2011	2012
Number of Customers (Average) ⁽¹⁾					
Residential	34,326	34,901	35,215	35,463	35,547
Commercial	5,782	5,899	5,999	6,080	6,193
Irrigation	4,493	4,541	4,553	4,573	4,624
Industrial	115	117	113	116	118
Other ⁽¹⁾	121	118	118	119	120
Total Customers	44,837	45,576	45,998	46,351	46,602
Energy Sales (MWh) ⁽¹⁾					
Residential	750,149	819,448	729,695	782,633	743,412
Commercial	444,447	467,134	439,988	467,188	457,325
Irrigation	555,748	541,930	503,706	509,086	536,381
Industrial	1,773,930	1,881,258	2,198,721	2,273,282	2,193,138
Other ⁽²⁾	5,648	5,896	6,044	6,419	6,366
Total Energy Sales	3,529,922	3,715,666	3,878,154	4,038,608	3,936,622
System Peak (MW)					
Winter	589	660	643	655	665
Summer	623	640	662	664	615
Revenues from Energy Sales (\$000) ⁽¹⁾					
Residential	\$ 31,926	\$ 33,211	\$ 31,252	\$ 34,342	\$ 35,898
Commercial	15,346	15,658	15,507	17,114	18,380
Irrigation	16,556	16,422	16,295	17,271	19,501
Industrial	46,427	48,602	58,865	65,071	69,113
Other ⁽²⁾	931	971	981	1,006	1,019
Total Revenues	\$ 111,186	\$ 114,864	\$ 122,900	\$ 134,804	\$ 143,911

(1) Statistics reported by class of service classification.

(2) "Other" includes street lighting, public authorities and non-firm retail energy sales.

The Electric System has experienced a stable residential customer base over the past five years. It is estimated that over 90% of all homes in the District's service area are electrically heated. Only the cities of Moses Lake, Quincy and Warden have natural gas service available. The single most important variable in power sales to residential accounts from year to year is weather as it relates to heating and cooling requirements. For example, in 2009 there was a colder than normal winter and hotter than normal summer. The MWh usage in industrial accounts from 2008 to 2012 grew 24%.

Power Supply Management and Power Marketing

The power generated at the Priest Rapids Project is a low cost resource for the Electric System. However, the amount of generation that is available to deliver over any given time period is highly variable. Minimal storage is available in the reservoirs of the Priest Rapids Development and Wanapum Development and the Developments are considered "run of the river" operations. The amount of energy generated at the Priest Rapids Project depends on the amount of water released from upstream reservoirs. See "THE PRIEST RAPIDS PROJECT." Columbia River flow is coordinated to meet a number of constraints, including optimizing generation, providing minimum flows for fish, and meeting other operational constraints. Regional weather conditions also influence the amount of flow made available for generation, varying from high water conditions to drought conditions. This variation in flow

generates surplus energy in some periods and a need for the Electric System to purchase energy in other periods. To manage Electric System resources in this variable environment, the Electric System uses a statistically produced exceedance curve based on historical and projected data to produce the most likely scenario for the following year. The statistical curve is updated to include current year information as actual data become available. This statistical curve is used as a baseline to project available power from the Priest Rapids Project. Additional firm resources are included in this planning. Market purchases are made in periods that are forecast to generate a deficit, and sales are made in periods where critical planning would forecast a surplus.

The Electric System's retail load is also variable. Some industrial loads served by the Electric System have an elastic demand curve for electricity. Residential, commercial and irrigation consumption are significantly affected by weather. To manage these variable resource and system requirements, the District enters into a number of wholesale energy transactions. These include purchases and sales in the daily and real-time markets. The District also is routinely a party to a number of other short-term power and capacity contracts.

The District's power marketing activities are confined to balancing District loads and resources and optimizing the value of the Priest Rapids Project with the intent of maximizing the benefit for Electric System retail customers. Power is purchased only to meet Electric System projected loads. Power surplus to the Electric System's needs is resold in a manner that seeks to provide the greatest value.

The District's annual firm energy resource requirements are fully satisfied by the District's rights under the Priest Rapids Project Power Sales Contracts. These rights result in surplus secondary energy available for resale in the wholesale markets on average. As a result, the District has historically generated substantial revenues from energy sales to other utilities. However, the revenues vary from year to year based on variations in generation and wholesale prices.

The District and PacifiCorp entered into an agreement for the sale of 14 MW of firm capacity and 87,600 MWh of energy annually to PacifiCorp, which contract terminated on August 15, 2012. The capacity and energy associated with the PacifiCorp contract is now available to the District for its own use. The District also sells surplus firm and non-firm energy on an "as available" basis to various municipally-owned and investor-owned utilities both within and outside the Pacific Northwest. The District's low-cost power supply has made it possible for the District to sell its surplus power to utilities in the Pacific Northwest and Southwest.

The District has entered into contracts to sell portions of the Electric System's share from the Priest Rapids Project to Iberdrola Renewables, Inc and Shell Energy North America, LP. The Iberdrola contract was effective December 1, 2011, and terminates November 30, 2014. The Shell contract is effective July 1, 2013, and terminates June 30, 2016. The contracts with Iberdrola and Shell are for a 12% and 10% slice, respectively, of the Priest Rapids Project. The purposes of these sales and an associated schedule of firm, fixed-price power purchases by the Electric System are to hedge water volume and operational risks through greater portfolio diversification. The associated schedule of firm fixed price power purchases was developed to achieve the stated goal of a reduction in the operational and water volume risk while creating no additional deficit volume or associated price risk in any monthly position under certain forecast assumptions; the District's 85% exceedance forecast was applied to the Iberdrola purchased quantities, while the District's 50% exceedance forecast was used to determine the Shell purchased quantities (i.e., no incremental monthly "short" exposure resulted at the respective exceedance levels from the hedge strategy although the average "long" position was reduced). These slice sales of the Priest Rapids Project output increase District net revenue stability by improving the predictability of wholesale revenues. The \$104.4 million and \$102.4 million contracts for Iberdrola and Shell, respectively, are paid in 36 equal monthly installments over the lives of the agreements. The District has the right to curtail delivery in the event of non-payment.

The table below summarizes wholesale power sales, including the portion of the District's share of the Priest Rapids Project's output in excess of the Electric System's needs, and the average price for the calendar years 2008 through 2012.

Table 5
ELECTRIC SYSTEM
WHOLESALE ENERGY SALES⁽¹⁾

	2008	2009 ⁽²⁾	2010 ⁽²⁾	2011 ⁽²⁾	2012
Wholesale Energy Sales (\$000) ⁽¹⁾	\$ 115,636	\$ 87,908	\$ 86,385	\$ 100,547	\$ 61,782
Total MWh ⁽³⁾	4,020,567	3,111,968	2,777,244	3,927,447	2,334,279
Average Revenue (\$/MWh)	\$ 28.76	\$ 28.25	\$ 31.10	\$ 25.60	\$ 26.47

(1) Sales to other utilities and power marketing entities.

(2) Decrease due to lower generation from the Priest Rapids Project and/or lower market prices.

(3) Run-off was 92% of average in 2008, 82% of average in 2009, 81% of average in 2010, 127% of average in 2011 and 122% of average in 2012. Decrease in 2012 due to termination of the Displacement Sales associated with the prior Bonneville contract and the Priest Rapids Project Power Sales Contracts.

To mitigate risks associated with power marketing activities, the District has established risk management guidelines that have been adopted by the Commission. In recognition of the increasing number of power transactions, price volatility and changing power supply contracts, the Commission established a Risk Oversight Committee in 2001 to review and update the energy risk management policies of the District and to provide greater ongoing monitoring and review of power transactions. The Risk Oversight Committee undertook a review by a utility consultant of the District's policies and controls, which was completed in the summer of 2001. Utilizing the recommendations of this report, the Risk Oversight Committee developed Energy Risk Management Policies that were adopted by the Commission. The Energy Risk Management Policy and Procedures outline the parameters for transaction, trader and counterparty exposure. Key elements of the policies include: (1) sales and purchases shall only be made to meet the District's prospective needs, to dispose of surplus power and to maximize use of the Priest Rapids and Wanapum Development reservoirs; no speculative sales or purchases are to be made; (2) power transactions shall not exceed a duration of 12 months without Commission approval; (3) the District's net position in MWhs is actively projected using a probabilistic forecast based upon a statistically produced exceedance curve for a rolling 18-month period; position limits are set to ensure prudent action by District personnel; (4) counterparty credit must be established and maintained to District requirements or acceptable credit enhancements must be obtained; individual counterparty credit limits have been established and are reviewed by the Risk Oversight Committee and individual credit exposure is monitored in relation to a percentage of total outstanding transactions; (5) traders are authorized to sell and purchase both physical and financial power (long and near term), options, ancillary services, renewable energy credits ("RECs") and REC options, which trades are made to hedge the District's position, sell surplus power or purchase power where the District is in a deficit position; and (6) monitoring reports describing all concluded transactions and expected future transactions (priced to current market prices) as compared to the District's adopted budget for that year are reviewed by District management on a frequent basis. The District believes that these policies limit the risk of any substantial financial loss resulting from the District's power supply management activities.

The District has entered into hedging agreements in the form of International Swaps and Derivatives Association ("ISDA") agreements with two different entities. The agreements are designed to manage price risk associated with power transactions and, in all cases, will be used to hedge the risk of an underlying physical position. The District does not, at this time, anticipate executing any further ISDA agreements. The ISDA agreements require that the District post collateral in the form of a letter of credit to secure its obligation to pay under the contracts if certain predetermined thresholds are met or the counterparty has commercially reasonable grounds for insecurity regarding the District's performance. Thresholds on the two agreements in place are currently at 3.5 times the District's internally-allowed credit exposures. Credit exposures are monitored continuously and calculated weekly on notional and mark-to-market values. In the event that credit exposure approaches a predetermined threshold, the District would determine the most appropriate course of action including, but not limited to, trading out of the given transactions. If no other action was deemed to be in the best interest of the District, the District would proceed to provide a letter of credit or collateral within 20 business days depending on the triggering event. The collateral provisions are reciprocal, meaning that the District has the right to ask its counterparties to post collateral if the exposure of the forward transactions moves in the District's favor and the predetermined thresholds are met.

The District has been active in the evaluation and monitoring of the reporting and record keeping requirements set forth by the Dodd-Frank Act. The legislation, enacted in July 2010, aims to prevent another significant financial crisis by creating new financial regulatory processes that enforce transparency and accountability, while implementing rules for consumer protection. While the District is not significantly affected by this legislation, the District, on an annual basis, may have a limited number of transactions related to power that have reporting and/or record keeping requirements to fulfill.

Rates

The District is empowered and required under the Enabling Act and by the covenants of the Bond Resolution to establish, maintain, and collect rates and charges for electric power and energy and other services sold through the Electric System adequate to provide revenues sufficient for the punctual payment of the principal of, premium, if any, and interest on all outstanding indebtedness, to pay for the proper operation and maintenance expenses of the Electric System and to make all necessary repairs, replacements and renewals thereof. The District has the exclusive authority to set retail rates and charges for retail electric energy and services and is by law free from the rate-making jurisdiction and control of the Washington Utilities and Transportation Commission or any other state or local agency having the authority to set rates and charges for retail electric energy and services. Under the Enabling Act, the District is required to establish, maintain and collect rates or charges that are fair and nondiscriminatory and adequate to provide revenues sufficient for the payment of the principal of and the interest on revenue obligations for which the payment has not otherwise been provided and for other purposes set forth in the Enabling Act.

A person or entity that has requested wholesale telecommunications services from a public utility district may petition the Washington Utilities and Transportation Commission if it believes that the District's rates, terms and conditions are unduly or unreasonably discriminatory or preferential. The commission may issue an order finding non-compliance. The District charges wholesale providers of telecommunications services based on a published rate schedule.

The Public Utility Regulatory Policies Act of 1978 ("PURPA") requires certain utilities, including the District, to consider and make determinations after public hearings regarding a set of federal standards that have three statutory purposes: end-use conservation, utility efficiency and equitable rates. The District has adopted certain standards relating to, among other things, rates, metering and advertising.

The following table shows a comparison of the District's monthly electric rates for selected residential, commercial and industrial loads with the rates charged by certain major municipal and investor-owned Pacific Northwest utilities. The comparative monthly electric bills shown are based on specific rate schedules for each utility; the use of other schedules applicable to particular customers will yield different results. The District's electrical rates are among the lowest in the nation. The average annual residential power bill (including city taxes) for the District in 2012 was \$996 and the average cost per kWh for residential service (including city taxes) in the District was 4.76 cents.

Table 6
ELECTRIC SYSTEM
MONTHLY ELECTRIC BILLS COMPARISON⁽¹⁾
As of June 1, 2013
(Winter Rates where applicable)

	Residential (1,500 kWh)	Commercial (30 kW 9,000 kWh)	Industrial (400 kW 150,000 kWh)
The District	\$77	\$386	\$4,678
Washington State Public Utility Districts			
Benton County PUD No. 1	114	565	9,451
Chelan County PUD No. 1	48	260	4,502
Clark Public Utilities	134	718	10,131
Cowlitz County PUD No. 1	106	746	11,060
Douglas County PUD No. 1	45	220	3,995
Franklin County PUD No. 1	125	661	9,341
Grays Harbor County PUD No. 1	134	758	11,392
Kittitas County PUD No. 1	149	806	9,765
Klickitat County PUD No. 1	141	602	10,507
Lewis County PUD No. 1	91	478	7,369
Mason County PUD No. 3	119	670	9,258
Snohomish County PUD No. 1	138	764	11,815
Washington Cities			
City of Ellensburg	107	618	9,081
City of Richland	105	410	7,147
City of Seattle	136	644	9,342
City of Tacoma	116	696	8,493
Private Power Companies			
Avista	123	909	12,780
Pacific Power (a PacifiCorp Company)	126	711	9,976
Portland General Electric	165	799	12,495
Puget Sound Energy	156	832	13,227

(1) Computed from the rate schedules provided by or found on the websites of the utilities listed. There are some variations in rate schedules and rate classification of the various utilities.

Source: The District and individual utilities.

The District maintains rates for electric service that are designed to recoup costs associated with power production/purchases, operations, maintenance and debt service for the Electric System. Wholesale revenues are designated in the District’s financial planning to offset future debt and build cash reserves. The following table shows the District’s rate increases since 2000.

**Table 7
ELECTRIC SYSTEM
RECENT RETAIL RATE INCREASES**

Date	Percentage Increase
April 1, 2000	3%
April 1, 2003	4
April 1, 2010	4
February 1, 2011	6
February 1, 2012	8
January 1, 2013	6

The District currently forecasts rate increases averaging 2% annually beginning in 2014. The Commission has final authority over the timing and frequency of rate modifications.

The Electric System’s Power Supply

In 2012, the Electric System obtained approximately 83% of its annual resources from the District’s share of the Priest Rapids Project and the remainder from the Quincy Chute Hydroelectric Project, P.E.C. Headworks Powerplant Project, Nine Canyon Wind Project, the Bonneville contract, and market purchases. Since 2005, the Power Sales Contracts for the Priest Rapids Project have permitted the District to increase its share of power from the Priest Rapids Project, which has significantly reduced the District’s reliance on power from Bonneville. Effective October 1, 2011, the District purchases only 1% of its power from Bonneville to serve loads in the Grand Coulee area which are not easily served from District resources.

Quincy Chute Project

Under an agreement with three irrigation districts, the District purchases the entire capability and output of and operates the Quincy Chute Project, a 9.4 MW hydroelectric generating facility operating seasonally during the irrigation season (March through October). The District financed, designed and constructed the project and is responsible for operation and maintenance during the period of the agreement, which expires in 2025. The Quincy Chute Project began commercial operation on October 1, 1985, and its net energy generation was 33,271 MWh in 2012.

P.E.C. Headworks Powerplant Project

Under an agreement with three irrigation districts, the District purchased the entire capability and output of and operates a 6.5 MW generating facility at the P.E.C. Headworks at the O’Sullivan Dam, which operates during the irrigation season (March through October). The District financed, designed and constructed the project and is responsible for operation and maintenance during the period of the agreement, which expires in 2030. The P.E.C. Headworks Project began commercial operation on September 1, 1990, and its net energy generation was 23,043 MWh in 2012.

Bonneville Power Administration Contracts

Bonneville was established by the Bonneville Project Act of 1937. Bonneville markets power from 31 federal hydroelectric projects, several non-federally owned hydroelectric and thermal projects in the Pacific Northwest, and various contractual rights (the “Federal System”). These projects, built and operated by the United States Bureau of Reclamation and the United States Army Corps of Engineers, are located in the Columbia River basin. The Federal System currently produces more than one-third of the region’s electric energy requirements. Bonneville’s

transmission system includes over 15,000 circuit miles of transmission lines, provides about 75% of the Pacific Northwest's high-voltage bulk transmission capacity, and serves as the main power grid for the Pacific Northwest. Bonneville sells electric power at wholesale rates to more than 125 utility, industrial and governmental customers in the Pacific Northwest. Its service area covers over 300,000 square miles and has a population of about 12 million.

The District's Priority Firm power contract with Bonneville, effective October 1, 2011, and terminating October 1, 2028, provides that Bonneville serves only the District's loads in the Grand Coulee area, which is a small area not easily served by the Priest Rapids Project. The District does not have a contract with Bonneville to serve any other District loads.

Bonneville is required by federal law to recover all of its costs through the rates it charges its customers. Under Bonneville's adopted rate methodology, which is in effect for the term of the current customer contracts, Bonneville's rates enable Bonneville to recover its actual costs of service. Under the Bonneville contracts, Bonneville will conduct a rate case every two or three years.

Transmission

The District has entered into two standard point-to-point ("PTP") transmission contracts for the purpose of transmitting Priest Rapids Project power. These include a two-year 250 MW PTP contract expiring on September 30, 2013 and a five-year 150 MW PTP contract expiring on December 31, 2015. The five-year contract contains long-term rollover rights that the District may elect to exercise.

Bonneville's transmission facilities interconnect with the British Columbia Hydro and Power Authority ("B.C. Hydro") in the Canadian province of British Columbia and with utilities in the Pacific Southwest. Bonneville's transmission system includes approximately 360 substations, 15,000 circuit miles of high voltage transmission lines, and other related facilities. This transmission system provides about 75% of the Pacific Northwest's high-voltage bulk transmission capacity and serves as the main power grid for the Pacific Northwest. In addition to federal power, the major portion of the power produced from several nonfederal projects, including the Priest Rapids Project, is transmitted over Bonneville's transmission facilities to various investor-owned and municipally-owned utilities in the Pacific Northwest. Bonneville routinely provides both long and short-term transmission access to utilities for the purpose of wheeling power within the Pacific Northwest.

A group of investor and consumer owned utilities, along with Bonneville, created "ColumbiaGrid" in 2006. Currently, this organization, of which the District is a member, is providing transmission planning services to members in the Pacific Northwest. ColumbiaGrid is not a regional transmission organization and provides services on a bilateral, contractual basis.

Wapato Hydroelectric Project

The District entered into a long-term purchase power agreement with the Yakama Nation for the output of the Wapato Hydroelectric Project. The Wapato Hydroelectric Project consists of two plants and is located within the boundaries of the Yakama Indian Reservation in Yakima County, Washington, and irrigates about 142,000 acres. The hydroelectric output from the Wapato Hydroelectric Project was approximately 0.5 aMW in 2012 and is expected to be approximately 0.5 aMW in 2013. The output is seasonal and concurrent with the irrigation season that runs from May through October. The rated capacities of the Wapato Hydroelectric Projects are 1.6 MW and 2.5 MW, respectively.

Nine Canyon Wind Project

The District entered into a power purchase agreement with Energy Northwest for the purchase of 25% of the generating capacity of Phase I of the 48.1 MW Nine Canyon Wind Project. The power purchase agreement will terminate on July 1, 2030. The Nine Canyon Wind Project is a wind energy generation project located approximately eight miles southeast of Kennewick, Washington in the Horse Heaven Hills.

Phase I of the project became commercially operable in 2002. Costs of constructing the project were financed through the issuance of \$70,675,000 of revenue bonds by Energy Northwest, which mature on July 1, 2023. Annual costs, including repayment of debt service, are paid by the purchasers. The District could be required to pay up to an additional 25% of the District's share of Phase I in the event of a default by another purchaser or purchasers. The actual net cost of power for the 12 months ended December 31, 2012 was \$65.43 per MWh. The projected net cost for calendar year 2013 is \$67.19 per MWh. Transmission costs vary depending on the variation of the wind resource.

Phase II of the Nine Canyon Wind Project went into commercial operation on December 31, 2003 with an additional 15.6 MW. Phase III of the Nine Canyon Wind Project became commercially operable in May 2008 and consists of an additional 14 wind turbines. While the District did not elect to participate in Phase II or Phase III, it did change the costs to the District. The District is responsible for 25% of the debt service costs of Phase I and 12.54% of the annual operating costs of the combined Phase I, Phase II and Phase III Nine Canyon Wind Project. In 2012, the District received approximately 31,905 MWh of wind generation output from the project and the District is projecting output from the project to be about 30,600 MWh in 2013.

Energy Conservation

The District is adapting its long-term customer advisory programs with a greater focus to educate its communities on the economic and societal benefits of conservation and efficiency and to empower them to make smarter, cost-effective decisions about their power consumption. The District offers a variety of conservation programs in an effort to meet the needs of its residential, commercial, agricultural and industrial customers. These programs are designed primarily to provide customers with cost-effective assistance to reduce their energy costs and to acquire cost-effective supplemental power resources to meet the District's loads.

The District has been actively involved in conservation programs since the Residential Conservation Service Program required by the National Energy Conservation Policy Act of 1978. As a result of the Pacific Northwest Electric Power Planning and Conservation Act (1980), Bonneville began implementing conservation programs for resource acquisition purposes. Utilities, including the District, carried out these programs on a local level. In 1995, Bonneville reduced its conservation programs, but the District, recognizing the value of promoting cost-effective energy conservation, voluntarily continued to promote and finance programs without Bonneville's financial assistance.

In 2001, the District increased conservation activities based on the Bonneville Conservation and Renewables Discount ("C&RD") program, which over five-years provided approximately \$3,650,000 in benefits that enabled the District to spend less on wholesale energy purchases and use the savings to fund local conservation activities. In 2006, the District continued its conservation activities and implemented an early start option in the Bonneville Conservation Rate Credit ("CRC") program. Between 2006 and 2009, the District received approximately \$846,600 per year from the CRC program. Bonneville renewed the CRC funding for 2010 and 2011 at the same level as the rate period ending in 2009. Bonneville also offered additional conservation funding for the five-year rate period ending in 2014. This was offered through the Energy Conservation Agreement ("ECA" funds), which the District signed. The District received a conservation budget of \$6,312,000 for the 12-months ending September 30, 2011 from Bonneville. For the Bonneville rate period 2012 and 2013, the ECA budget will be reduced to \$70,580. This reduction is due to the decrease in power purchases from Bonneville. District funds will be used for the majority of cost-effective conservation and energy efficiency projects in the future.

Conservation opportunities are being actively pursued by the District to achieve a least-cost power supply. Conservation cost-effectiveness will be measured against the avoided cost of the next new resource available to the District, as defined by the Washington Constitution and State law. The amount spent for programs each year is

established through the District's annual budgeting process. Pursuant to requirements in State Initiative 937, the District has set conservation MWh targets for the years 2012 through 2021 and will review and set new ten-year targets every two years. The ten-year target was set at 244,565.7 MWh with a second biennium target of 48,913 MWh. These targets will be met by conservation coming from existing programs and any new conservation programs created during the target period. See "Legislation and Initiatives" below.

Energy Northwest

The District is a member of Energy Northwest and a participant in Energy Northwest's Nuclear Projects Nos. 1 and 3, which have been terminated. The District, Energy Northwest, and Bonneville have entered into separate Net Billing Agreements with respect to approximately \$2.716 billion in outstanding bonds for Energy Northwest's Project No. 1 and 70% ownership share of Project No. 3 (collectively, the "Net Billed Projects"). Under the agreements, the District is unconditionally obligated to pay Energy Northwest its pro rata share of the total costs of the projects, including debt service, whether or not construction is terminated. The District's assignment of these project costs have been assumed by Bonneville at the levels of 0.486% and 0.420% of the capability of Project No. 1 and Energy Northwest's ownership share of Project No. 3, respectively. Under the Net Billing Agreements, Bonneville is responsible for the District's percentage share of the total annual cost of each project, including debt service on revenue bonds issued to finance the costs of construction. The District's revenue requirements are affected only to the extent that the costs of the projects result in increases in Bonneville's wholesale power rates. Notwithstanding the assignment of the District's share of the capability of a Net Billed Project to Bonneville, the District remains unconditionally obligated to pay to Energy Northwest its share of the total annual cost of the Net Billed Project to the extent payments or credits relating to such annual cost are not received by Energy Northwest from Bonneville.

Future Resources

The District has evaluated resource additions to minimize District exposure to variations in water supply and market prices in serving energy demand in excess of its existing resource entitlements. Under evaluation were clean, renewable energy projects such as in-county solar, wind and biomass projects, which would assist the District in meeting the requirements of the Renewable Portfolio Standard as set by I-937. The preferred resource alternative was identified as a mix of short, medium and long term market purchases. It is possible that the District could issue debt to finance one or more projects. See "Legislation and Initiatives." Other energy sources under consideration are a natural gas fired resource, small agricultural waste fired steam turbines, and hydro-kinetic energy within the in-county canal system.

Legislation and Initiatives

Initiative 937 (Renewable Portfolio Standards)

State Initiative 937, the Energy Independence Act ("EIA" or "I-937"), which was approved at the November 6, 2006, election, requires electric utilities that serve more than 25,000 customers to obtain at least (a) 3% of their electricity from eligible renewable resources by January 1, 2012, and each year thereafter through December 31, 2015; (b) 9% of their electricity from eligible renewable resources by January 1, 2016, and each year thereafter through December 31, 2019; and (c) 15% of their electricity from eligible renewable resources by January 1, 2020, and each year thereafter. I-937 also requires qualifying electric utilities to undertake various cost-effective energy conservation efforts. The Commission approved the District's 10-year conservation plan and two-year conservation target, pursuant to the provisions of I-937. To satisfy the I-937 requirements, the District intends to rely on its share of the Nine Canyon Wind Project and the incremental hydroelectric generation resulting from the Wanapum Development fish bypass, the Priest Rapids Development fish bypass and the turbine and generator upgrades at the Priest Rapids Project. The District met its 2012 target for renewable energy under I-937 and has submitted its compliance documents which should satisfy its 2013 requirements. The District expects that its available qualifying renewable generation will meet the requirements of I-937.

Climate Change

Federal, regional, state and international initiatives have been proposed or adopted to address global climate change by controlling or monitoring greenhouse gas emissions, by encouraging renewable energy development and by implementing other measures. The District cannot predict whether or when new laws and regulations or proposed initiatives would take effect in a manner that would affect the District, and if so, how they would affect the District. The physical effects of climate change could affect the amount, timing, cost and availability of hydroelectric power.

The Washington Legislature enacted legislation requiring the Governor to develop policy recommendations for achieving specific greenhouse gas reduction targets and requiring that power supply contracts of five years or more comply with certain emission standards. Proposed federal energy legislation could set national standards for renewable energy generation, conservation efforts, and encourage greenhouse gas reduction. While the District's resources are primarily hydroelectric based, it is possible that legislation regarding greenhouse gas reduction could impact the District.

Telecommunications

The Wholesale Fiber Optic Network

The District began developing an internal fiber optic telecommunications system in the 1980s. That system now links the Priest Rapids and Wanapum Developments, most of its substations, all local offices and the District's headquarters building. This system created a fiber optics "backbone" which has significant excess capacity. The District began installing a Wholesale Fiber Optic Network (formerly referred to as the "Zipp Network") in its service area starting in 2000. The Wholesale Fiber Optic Network was established to provide wholesale telecommunications services to retail providers of high speed internet, wireless, security, video and telephone services to businesses and residents within Grant County.

The District has strung fiber on its existing electric utility poles and has installed community "hubs" at various locations around the District. Commercial and residential customers are connected to the Wholesale Fiber Optic Network's fiber run by the District directly to their homes and businesses from the hubs. Wholesale Fiber Optic Network users thus receive various telecommunications services at rates as high as 100 Megabits per second.

As of December 31, 2012, the District's Wholesale Fiber Optic Network was available to 24,460 homes and businesses within Grant County. Currently 7,346 users subscribe to services from the existing group of retail providers. The Wholesale Fiber Optic Network currently has about 16 internet service providers, four telephone service providers, and one video service provider, all of which are small local or regional companies. The retail service providers are charged for use of the Wholesale Fiber Optic Network system pursuant to a generally applicable rate schedule approved by the Commission. These wholesale rates are generally set by the Commission to allow the retail services to be competitive from a cost standpoint with other available options. The District currently is free from any significant Federal or State regulation with respect to the Wholesale Fiber Optic Network.

The Commission established financial goals for the Wholesale Fiber Optic Network and expectations for funding expansion over the next several years. In 2011 and 2012, the District spent \$5.1 million and \$11.2 million, respectively, for Wholesale Fiber Optic Network expansion and capital improvements. The approved capital budget for 2013 includes \$6.1 million and forecasts an additional \$5 million through 2014. The District experienced an 11% growth in wholesale fiber services revenue through December 2012 compared to December 2011.

The Wholesale Fiber Optic Network is operated and accounted for as part of the Electric System. Through the year ended December 31, 2012, the District had invested more than \$139 million in its telecommunications system facilities and equipment, including from Electric System bond proceeds and other available funds. This amount does not include the "backbone" part of the system that was built to serve internal District purposes, or net operating losses incurred by the Electric System with respect to the Wholesale Fiber Optic Network since it was first established. These net operating losses (including depreciation) currently amount to approximately \$3 to \$5 million each year. Excluding depreciation, there is no annual net operating loss. These losses are expected to continue for the foreseeable future. See APPENDIX B—"AUDITED FINANCIAL STATEMENTS OF THE DISTRICT AS OF

DECEMBER 31, 2012 AND 2011,” including in particular Note 11, for additional financial and other information regarding the District’s telecommunications system.

NoaNet

The District, along with nine other Washington public utility districts and Energy Northwest, is a member of Northwest Open Access Network (“NoaNet”). NoaNet, a Washington nonprofit mutual corporation, was established in 2000 to provide its members with a broadband communications backbone throughout the State of Washington using “public benefit” fibers leased by NoaNet from Bonneville. This was done to assist NoaNet’s members in the more efficient management of loads, energy conservation measures, and the acquisition of electric energy, as well as for other purposes. The network began commercial operations in 2001.

In 2001, NoaNet issued \$27 million in bonds to finance, among other things, the acquisition and construction of necessary facilities and systems. In June 2011, NoaNet issued \$13,165,000 to refund most of the NoaNet 2001 bonds. The Electric System has guaranteed the repayment of up to approximately \$1.9 million of NoaNet’s remaining 2011 bonds (which amount includes a potential 25% step up if another member defaults) plus accrued interest. In addition, NoaNet has outstanding a \$5 million bank loan and approximately \$3 million non-revolving lines of credit with a commercial lender in order to finance capital expenditures and network upgrades, of which the District has guaranteed, or to which the NoaNet board has pledged to assess the District for, the repayment of up to 17.57% of the outstanding balance to the extent NoaNet’s revenues are insufficient to pay the loans. The District contributed \$129,552 and \$70,300 to NoaNet in 2010 and 2011, respectively. No contributions were required for 2012.

Outstanding Long-Term Debt of the District

The table below lists the outstanding long term debt of the District prior to the issuance of the Bonds.

Table 8
SUMMARY OF OUTSTANDING LONG TERM DEBT OF THE DISTRICT
Expected as of September 1, 2013

System(1)	Series	Date of Final Maturity	Principal Amount		Total Original (\$000)	Total Outstanding (\$000)
			Original (\$000)	Outstanding (\$000)		
Electric System	2011-I	1/1/2023	\$ 156,070	\$ 140,480*	\$ 156,070	\$ 140,480*
Priest Rapids Development	2003-Z	1/1/2021	\$ 18,450	\$ 11,470		
	2005-A	1/1/2033	69,050	50,360		
	2005-B	1/1/2033	26,780	22,395		
	2005-Z	1/1/2033	43,685	33,680		
	2006-A	1/1/2036	24,770	21,800		
	2006-B	1/1/2017	5,470	1,980		
	2006-Z	1/1/2036	36,370	32,620	224,575	174,305
Wanapum Development	2003-Z	1/1/2021	\$ 20,135	\$ 12,520		
	2005-A	1/1/2038	52,325	24,535		
	2005-B	1/1/2038	71,050	62,515		
	2005-Z	1/1/2018	4,405	2,175		
	2006-A	1/1/2043	71,395	62,985		
	2006-B	1/1/2031	18,190	12,020		
	2006-Z	1/1/2043	96,845	89,715	334,345	266,465
Priest Rapids Project	2010-A	1/1/2023	\$ 40,265	\$ 29,410		
	2010-B	1/1/2018	10,665	7,380		
	2010-L	1/1/2040	173,915	173,915		
	2010-M	1/1/2027	90,000	90,000		
	2010-Z	1/1/2040	34,585	33,635		
	2012-A	1/1/2035	54,510	53,985		
	2012-B	1/1/2023	16,235	15,490		
	2012-M	1/1/2032	42,395	42,395		
	2012-Z	1/1/2035	14,480	14,350		
	2013-A	1/1/2043	69,690	69,690		
	2013-Z	1/1/2043	30,380	30,380	577,120	560,630
Total			\$1,292,110	\$1,141,880	\$ 1,292,110	\$1,141,880

(1) In 2010, the Priest Rapids Development and Wanapum Development were combined into one system, the Priest Rapids Project. Bonds issued prior to 2010 are identified in the column by the Development for which they were issued.

* A portion will be refunded with Bond proceeds.

Electric System Operating Results

The following table shows the Electric System's historical operating results for fiscal years 2008 through 2012. This table is designed to show compliance with the debt service coverage requirements in the Bond Resolution. As a result, it differs from the financial statements in Appendix B, because it does not follow all of the accounting principles generally accepted in the United States.

Table 9
ELECTRIC SYSTEM HISTORICAL OPERATING RESULTS
(\$000)

	2008	2009	2010	2011	2012
Revenues					
Retail Energy Sales	\$ 111,186	\$ 114,864	\$ 122,900	\$ 134,804	\$ 143,911
Miscellaneous Electrical Revenues ⁽¹⁾	15,063	5,172	13,236	13,370	9,053
Sales to Other Utilities ⁽²⁾	115,636	87,908	86,385	100,547	61,782
Total Revenues	\$ 241,885	\$ 207,944	\$ 222,521	\$ 248,721	\$ 214,746
Expenses					
Power Supply Costs ⁽³⁾	\$ 109,808	\$ 127,015	\$ 148,349	\$ 143,769	\$ 107,774
Operation and Maintenance ⁽⁴⁾	26,614	29,457	31,121	29,000	32,602
Taxes	8,395	8,800	8,983	10,153	10,443
Total Expenses	\$ 144,817	\$ 165,272	\$ 188,453	\$ 182,922	\$ 150,819
Net Revenues	\$ 97,068	\$ 42,672	\$ 34,068	\$ 65,799	\$ 63,927
Interest and Other Income	\$ 5,436	\$ 1,644	\$ 577	\$ 949	\$ 1,273
Transfer to the Rate Stabilization Account⁽⁵⁾	--	--	--	(20,000)	--
Revenues Available for Debt Service Less Debt Service⁽⁶⁾	102,504	44,316	34,645	46,748	65,200
	(17,937)	(17,922)	(17,906)	(27,314)	(9,464)
Uncommitted Revenues	\$ 84,567	\$ 26,394	\$ 16,739	\$ 19,434	\$ 55,736
Beginning Working Capital	\$ 155,337	\$ 183,107	\$ 141,303	\$ 103,361	\$ 199,232
Bond Proceeds – Construction Fund	--	--	--	100,000	--
Funds Available for Construction Less Capital Construction	239,904	209,501	158,042	222,795	254,968
	(46,849)	(61,570)	(36,611)	(27,018)	(46,203)
Change in Other Balance Sheet Accounts	(9,948)	(6,628)	(18,070)	3,455	(31,825)
Ending Working Capital⁽⁷⁾	\$ 183,107	\$ 141,303	\$ 103,361	\$ 199,232	\$ 176,940
Reserve and Contingency Fund⁽⁸⁾	\$ 94,319	\$ 95,072	\$ 96,118	\$ 71,806	\$ 72,070
Debt Service Coverage	5.71x	2.47x	1.93x	1.71x	6.89x
Retail Energy Sales (MWh)	3,529,922	3,715,666	3,878,154	4,038,608	3,936,622
Average Retail Energy Rate Increase	0%	0%	4%	6%	8%
Average Retail Revenue Requirement (cents/kWh)	3.15¢	3.09¢	3.17¢	3.34¢	3.66¢

(1) The District recognized earned contributions in aid of construction of \$3,847,424, \$8,660,241, \$8,871,577, \$993,576 and \$9,058,551 in 2012, 2011, 2010, 2009 and 2008, respectively.

(2) The increase in 2011 was largely due to higher water flows (127% of average). The decreases in 2010 and 2009 were related to depressed market prices and lower water flows. The majority of the decrease from 2011 to 2012 was due to the termination of the Displacement Product. Sales in October 2011, which represented a new direct offset to Bonneville power costs for the same period.

(3) The increases in 2010 and 2009 were related to lower water flows for generation and increased power cost from the Priest Rapids Project. The majority of the decrease from 2011 to 2012 was due to the termination of the Bonneville contract in October 2011. The Electric System now uses power supplied by the Priest Rapids Project to serve the load previously supplied by Bonneville.

(4) Excludes noncash items of depreciation and amortization.

(5) In 2011, pursuant to Commission resolution, \$20 million was transferred to the Rate Stabilization Account from the Revenue Fund.

(6) Due to the 2011 Bonds and the effect on the timing of debt service payments, the debt service payment due on January 1 is shown in the prior calendar year.

(7) Includes amounts in the construction funds.

(8) In 2011, \$45.3 million from the Reserve and Contingency Fund was used to defease outstanding Electric System bonds. As of June 1, 2013, the balance in the Reserve and Contingency Fund was \$71.5 million.

The following table shows the Electric System's historical energy requirements, resources and power costs for fiscal years 2008 through 2012.

Table 10
ELECTRIC SYSTEM
HISTORICAL ENERGY REQUIREMENTS, RESOURCES AND POWER COSTS

	2008	2009	2010	2011	2012
Annual Energy Requirements (MWh)					
Retail Sales ⁽¹⁾	3,553,474	3,693,343	3,878,190	4,058,471	3,910,618
Electrical System Usage	11,067	11,892	11,336	11,307	13,412
Sales for Resale ⁽²⁾	4,020,567	3,111,968	2,777,244	3,927,447	2,334,279
Distribution/Transmission Line Losses	164,848	175,698	148,431	165,766	199,481
Total Energy Requirements	7,749,956	6,992,901	6,815,201	8,162,991	6,457,790
Annual Resources (MWh)					
Priest Rapids Project ⁽³⁾	4,000,144	3,651,136	4,036,382	5,715,363	5,337,812
Quincy Chute Project	35,570	32,805	32,336	32,430	33,271
PEC Headworks Project	23,533	20,700	22,746	13,314	23,043
Bonneville ⁽⁴⁾	1,718,103	1,704,937	1,704,796	1,352,243	50,027
Other	1,972,606	1,583,323	1,018,941	1,049,641	1,013,637
Total Energy Resources	7,749,956	6,992,901	6,815,201	8,162,991	6,457,790
Average Power Cost by Resource (cents/kWh)					
Priest Rapids Project ⁽³⁾	1.66¢	1.68¢	1.97¢	1.53¢	1.55¢
Quincy Chute Project	2.53	2.35	2.72	2.71	1.88
PEC Headworks Project	2.89	2.94	3.24	6.62	4.16
Bonneville	2.45	2.48	2.60	2.43	3.24
Annual Power Cost by Resource (\$000)					
Priest Rapids Project ⁽³⁾	\$ 66,216	\$ 61,199	\$ 79,698	\$ 87,179	\$ 82,985
Quincy Chute Project	899	771	879	880	624
PEC Headworks Project	681	609	736	882	958
Bonneville ⁽⁴⁾	42,082	42,323	44,244	32,908	1,620
Other ⁽⁵⁾	(5,493)	8,250	9,554	10,251	9,400
Wheeling	5,423	13,863	13,238	11,669	12,187
Total Power Costs (\$000)	\$ 109,808	\$ 127,015	\$ 148,349	\$143,769	\$107,774
Average Power Costs (cents/kWh)	1.42¢	1.82¢	2.18¢	1.76¢	1.67¢

(1) Reflects total retail energy requirements.

(2) Decrease in 2010 was due to decreased water for generation and low wholesale prices. Decrease in 2012 was due to the end of the Displacement Sales.

(3) During 2010, pursuant to Commission resolution, the Priest Rapids Development and the Wanapum Development were combined into one system, the Priest Rapids Project. Prior year disclosures for the Priest Rapids Development and the Wanapum Development have been combined for comparative purposes.

(4) The decrease in 2012 was due to the end of the Bonneville contract in October 2011.

(5) By virtue of the Priest Rapids Project Power Sales Contracts, the Electric System's estimated unmet load is met through cash proceeds from the auction of power from the Priest Rapids Project. The Electric System's contractual share of these proceeds exceeded the actual power purchases necessary for 2008.

Management's Discussion of Results

The Electric System has historically demonstrated consistently strong financial results with high debt service coverage ratios and a substantial buildup in reserves. The operating results for 2008 to 2012 reflect the benefits of the Power Sales Contracts that went into effect on November 1, 2005. The Power Sales Contracts have effectively enabled the Electric System to meet its load requirements with the low cost power from the Priest Rapids Project. 2008 was an exceptional year for generation of net operating revenue in the Electric System. Near average run-off provided generation sufficient to meet the Electric System's loads and provide ample surplus sales at healthy market prices. The years 2009 and 2010, while still profitable, reflected lower surplus sales revenues. Run-off on the Columbia River was below average, and the wholesale power prices were significantly lower than in prior years. Despite these challenges, the Electric System was able to produce net revenues of \$42 million and \$34 million in

2009 and 2010, respectively, as shown in Table 9. The years 2011 and 2012 had significant run-off (127% and 122% of average, respectively), and wholesale market prices continued to be low. This resulted in net revenues of \$65 million and \$64 million for 2011 and 2012, respectively.

The District has always met its debt service coverage covenants. The District added to its Rate Stabilization Account in 2006, 2007, and 2011. From 2008 to 2012, the Electric System’s debt service coverage ranged from 1.97 times to 5.80 times, well in excess of the 1.25 times required by the Bond Resolution.

From 2004 to 2010, the Electric System financed all capital improvements from revenue. The District’s financial parameters require on average a minimum of 50% revenue financing of capital expenditures for the Electric System.

The Commission approved a 6% rate increase effective January 1, 2013, following 8%, 6% and 4% increases in 2012, 2011 and 2010, respectively. The District forecasts annual rate increases of 2% in 2014 and subsequent years. These increases are designed to help the Electric System meet requirements for capital improvements, increasing costs of generation at the Priest Rapids Project, and increase the reserves of the Electric System. The increase in reserves is prudent to mitigate generation output fluctuations at the Priest Rapids Project due to water availability or spill requirements. Decreases in generation from the Priest Rapids Project below forecast levels require the Electric System to meet its load requirements with market purchases. This exposure to the market is best buffered by adequate reserve funds to help cushion rates from market volatility. These future rate increases may be modified to reflect future financial conditions.

Based on results to date and projections for the remainder of the year, the District expects that debt service coverage on Electric System bonds will be approximately 3.2 times in 2013. Net wholesale revenues (net of market sales and non-Priest Rapids Project power costs) account for approximately 20-25% of total Electric System revenue annually.

Capital Requirements

As part of its planning process, the District has prepared its annual estimate of the capital requirements for the Electric System. As shown in the table below, the capital requirements include provisions for major projects involving transmission and electrical distribution lines and substations as well as normal equipment purchases, system additions, customer extensions, and general plant purchases. The District expects the cost of these expenditures in 2013-2016 to be approximately \$200 million. The District is undertaking substantial capital improvements to serve expected load growth. In 2013, the District is concluding a significant investment installing the Rocky Ford-to-Columbia 230kv line. After completion of this project, Electric System capital improvements are expected to consist of routine system improvements. The District has customer contribution policies that require customers to pay a portion of the cost of the facilities the District installs on their behalf. The District currently does not anticipate issuing bonds to fund these capital improvements to the Electric System. See “Retail Energy Sales and Customers.”

**Table 11
ELECTRIC SYSTEM PROJECTED
CAPITAL IMPROVEMENTS PROGRAM 2013-2016**

Distribution	\$ 112,317,364
Transmission	40,375,288
Fiber	28,671,327
General Plant	19,389,603
	\$200,753,582

Various Factors Affecting the Electric Utility Industry

The electric utility industry in general has been, or in the future may be, affected by a number of factors which could impact the financial condition and competitiveness of many electric utilities and the level of utilization of generating and transmission facilities. In addition to the factors discussed above under “Legislation and Initiatives” and “THE PRIEST RAPIDS PROJECT,” such factors include, among others, (1) effects of compliance with rapidly changing environmental, safety, licensing, regulatory and legislative requirements, (2) changes from a market restructuring and/or implementation of centralized coordinated markets in the WECC, (3) changes resulting from conservation and demand-side management programs on the timing and use of electric energy, (4) changes resulting from a national energy policy, (5) issues relating to the ability to issue tax-exempt obligations, including restrictions on the ability to sell to nongovernmental entities electricity from generation projects and transmission service from transmission line projects financed with outstanding tax-exempt obligations, (6) effects of inflation on the operating and maintenance costs of an electric utility and its facilities, (7) changes from projected future load requirements, (8) increases in costs and capital, (9) shifts in the availability and relative costs of different fuels (including the cost of natural gas), (10) sudden and dramatic changes in the price of energy purchased or sold on the open market that may occur in times of high peak demand and/or oversupply, such as has occurred in California and the Pacific Northwest, (11) inadequate risk management procedures and practices with respect to, among other things, the purchase and sale of energy and transmission capacity, (12) other legislative changes, voter initiatives, referenda and statewide propositions, (13) effects of the changes in the economy, (14) effects of possible manipulation of the electric markets, (15) natural disasters or other physical calamities, including, but not limited to, earthquakes and floods and (16) changes to the climate. Any of these factors (as well as other factors) could have an adverse effect on the financial condition of any given electric utility and likely will affect individual utilities in different ways.

The District is unable to predict what impact such factors will have on its business operations and financial condition. This Official Statement includes a brief discussion of certain of these factors. This discussion does not purport to be comprehensive or definitive, and these matters are subject to change subsequent to the date hereof. Extensive information on the electric utility industry is available from the legislative and regulatory bodies and other sources in the public domain, and potential purchasers of the Bonds should obtain and review such information.

THE PRIEST RAPIDS PROJECT

Description

The Priest Rapids Project consists of the Priest Rapids Development and the Wanapum Development (the “Developments”). In 2010, the District combined the two Developments into one system, the Priest Rapids Project. The Priest Rapids Development consists of a dam and hydroelectric generating station that has been in commercial operation since 1961. The Wanapum Development consists of a dam and hydroelectric generating station that has been in commercial operation since 1963. The two developments are on the Columbia River approximately 18 miles apart.

The Priest Rapids Project is operated under a single license from the Federal Energy Regulatory Commission (“FERC”). The original license for the two Developments expired on October 31, 2005, and the District operated with annual licenses from 2005-2008. In 2008, the District was granted a new 44-year FERC license for the consolidated Priest Rapids Project. See “FERC License.”

The Priest Rapids Development

The Priest Rapids Development consists of a dam and hydroelectric generating station having a nameplate rating of 955.6 MW. Located on the Columbia River in Grant and Yakima Counties about 150 air miles northeast of Portland, Oregon, 130 air miles southeast of Seattle, Washington, and 18 miles downstream of the Wanapum Development, the Priest Rapids Development includes certain switching, transmission and other facilities necessary to deliver the electric output to the transmission networks of the District, Bonneville and certain other power purchasers.

The Wanapum Development

The Wanapum Development consists of a dam and hydroelectric generating station having a nameplate rating of 1,092.6 MW. Located on the Columbia River in Grant and Kittitas Counties about 160 air miles northeast of Portland, Oregon, 129 air miles southeast of Seattle, Washington, and 18 miles upstream of the Priest Rapids Development, the Wanapum Development includes certain switching, transmission and other facilities necessary to deliver the electric output to the transmission networks of the District, Bonneville and certain other power purchasers.

Energy Production

The following table shows the energy production for the Priest Rapids Project for the years 2008 to 2012. The major factors affecting Average Cost are annual variations in Columbia River water flows and increased debt service from bond issues to fund major rehabilitation and fish mitigation measures.

Table 12
PRIEST RAPIDS PROJECT HISTORICAL ENERGY PRODUCTION⁽¹⁾

	2008	2009	2010	2011	2012
Priest Rapids Project					
Net Peaking Production (MW)	1,799	1,782	1,767	1,779	1,756
Net Energy Production (000's MWh) ⁽²⁾	8,297	7,569	7,061	9,574	8,748
Annual Availability Factor ⁽³⁾	93%	90%	90%	90%	87%
Plant Factor ⁽⁴⁾	60%	56%	53%	69%	64%
Average Cost (\$/MWh)	\$14.44	\$14.58	\$18.97	\$14.64	\$15.47
Bonneville Power PF Rate (\$/MWh) ⁽⁵⁾	\$27.10	\$26.60	\$28.50	\$28.50	\$30.30

- (1) During 2010, pursuant to Commission resolution, the Priest Rapids Development and the Wanapum Development were combined into one system, the Priest Rapids Project. Prior year disclosures for the Priest Rapids Development and the Wanapum Development have been combined for comparative purposes.
- (2) Run-off was 81% of average in 2010, 127% of average in 2011 and 122% of average in 2012.
- (3) The ratio of the actual hours that the generating units of the Priest Rapids Project are available for service during the period indicated to the total hours in the period.
- (4) The average energy output of a generating facility to the net peaking capability of that facility. It reflects the facility's availability, the actual need for the power production by the facility and the availability of water. Plant factor is calculated by dividing gross generation by 8,760 (the hours in one year) divided by the maximum one-hour production.
- (5) Bonneville's published Priority Firm power rates.

Based on weather conditions and river run-off to date, it is expected that run-off in 2013 will be approximately 102% of average.

Power Sales Contracts

The District's current contracts for the purchase and sale of output from the Priest Rapids Project became effective on November 1, 2005 for the Priest Rapids Development and on November 1, 2009 for the Wanapum Development (the "Power Sales Contracts"). The Power Sales Contracts extend until the expiration of the license for the Priest Rapids Project (April 1, 2052). The Power Sales Contracts allow the District to meet the Electric System's retail load requirements at low cost Priest Rapids Project production into the foreseeable future and under most water conditions provide substantial excess power above load that can be sold into the wholesale market.

The Power Sales Contracts consist of the "Product Sales Contract" and the "Reasonable Portion Contract." The Power Sales Contracts are summarized in Appendix B. In accordance with the FERC order in the Public Law 83-544 proceeding, following the expiration of the 1956 Power Sales Contracts, the District dedicates 30% of the output of the Priest Rapids Project (the "Reasonable Portion") for sales within the region based on market principles. As further described below, the District's Electric System can use up to 63.3% of the output of the Priest Rapids Project to serve retail load, 6.7% is sold to certain purchasers other than the District (the "Power Purchasers"), via Exchange

Agreements and Product Sales Contracts, and the remaining 30% is the Reasonable Portion. Under the Power Sales Contracts, the District has the right to take or benefit from up to 93.3% of the generating capacity of the Priest Rapids Project. See “Regulatory Proceedings Affecting the Developments—*Allocation of Output*.”

The following table lists the Power Purchasers under the Power Sales Contracts and their percentage shares of the costs of the Priest Rapids Project.

Table 13
PARTICIPATION IN COSTS OF PRIEST RAPIDS PROJECT—2012

Power Purchaser	Percent Share	Priest Rapids Project Nameplate Rating ⁽¹⁾ (MW)
PacifiCorp Electric Operations	9.76%	199.904
Portland General Electric	9.76	199.904
Puget Sound Energy, Inc.	5.63	115.314
Seattle City Light	4.29	87.868
Avista Corporation	2.19	44.856
Tacoma Power	2.18	44.651
Public Utility District No. 1 of Cowlitz County	1.28	26.217
Eugene Water and Electric Board	1.09	22.325
Other Power Purchasers ⁽²⁾	2.50	51.205
The District’s Electric System	61.32	1,255.956
Total	100.00%	2,048.200

(1) Based on installed nameplate rating of 2,048.200 MW. The nameplate rating allocation is based on the percentage of power costs attributable to each power purchaser divided by the total nameplate rating. The allocation changes annually since each power purchaser’s percentage of the total power costs will change under the Power Sales Contracts.

(2) Cities of Forest Grove, McMinnville, and Milton-Freewater; Kittitas County PUD, Snake River Power, Clearwater Power, Idaho County Light, Kootenai Electric Cooperative, and Northern Lights.

The Power Sales Contracts include the following provisions:

- Under the Reasonable Portion Contract, the Power Purchasers receive the revenues from the sale of the 30% Reasonable Portion. The District offers the Reasonable Portion output for sale based on market principles. The District has the ability to claim revenues from the sale of the Reasonable Portion to the extent that the District must acquire additional power to meet its firm energy load requirements. The Power Purchasers are responsible for paying their proportionate share of all costs of the Priest Rapids Project associated with the Reasonable Portion regardless of the revenues produced from the Reasonable Portion Contract. If the District claims revenue from the sale of the Reasonable Portion, it pays its share of the costs of the Reasonable Portion. See “SECURITY FOR THE PARITY BONDS—Electric System Obligations for the Priest Rapids Project Bonds.”
- Under the Product Sales Contract, the District has the ability to take up to 70% of the Priest Rapids Project output. To the extent the District does not take the full 70%, the difference is allocated to the Power Purchasers (for 2013 the Power Purchasers are allocated 1.59%). The Product Sales Contract was amended to assign to the Purchasers up to 4.21% of the District’s 70% maximum. In return the District is able to use all generation in excess of firm generation. The amount of firm energy output required by the District each year is based on one-year projections of the District’s firm retail load compared to the projected firm energy output of the Priest Rapids Project based on critical water planning.

- Some of the smaller Power Purchasers have signed Exchange Agreements with the District, which assign to the District all of their rights and obligations under the Power Sales Contracts in exchange for a fixed percentage of output from the Priest Rapids Project for the term of the Power Sales Contracts. This makes up the 2.48% of the output of the Priest Rapids Project.

The Power Sales Contracts provide that each Power Purchaser will be obligated to make payments equal to annual power costs, which include all operating expenses and debt service on the Parity Bonds and debt service coverage (currently 15% of Annual Debt Service) for the life of the Power Sales Contracts, multiplied by the percentage of output or revenue, as applicable, that the purchaser is entitled to that year. The Power Sales Contracts provide that the Power Purchasers shall pay their portion of the estimated costs of the Priest Rapids Project irrespective of the condition of the Priest Rapids Project and whether or not the Priest Rapids Project is capable of producing power or revenues. If the Priest Rapids Project is unable to operate, estimated costs will be based on output in the last full year of operation. See “SECURITY FOR THE PARITY BONDS—Electric System Obligations for the Priest Rapids Project Bonds” for a description of the Electric System covenant to take power and pay costs associated with its share of power received from the Priest Rapids Project.

Sale of Reasonable Portion

Pursuant to federal legislation and a FERC order, the District is required to sell 30% of the Priest Rapids Project power pursuant to market-based principles. The District sells at auction a minimum of 3% of the Priest Rapids Project output. The District also sells at auction the amount of power that the Power Purchasers elect not to take. The auction sets the price Power Purchasers must pay for their share of the Reasonable Portion which they elect to take. These Power Purchasers in turn receive a like, offsetting portion of Reasonable Portion revenues, which effectively provides these Power Purchasers with power at Priest Rapids Project cost. The District has seen active participation in the auction of the Reasonable Portion. Auctions covering the period of November 1, 2005 to October 31, 2009 were for slices of the Priest Rapids Development. Auctions covering the period of November 1, 2009 forward are for slices of the Priest Rapids Project, which includes both the Priest Rapids and Wanapum Developments. Since they began in 2005, the auctions have generated a significant premium above the underlying energy value. The following table summarizes the auction winners from 2009 through 2013.

Table 14
REASONABLE PORTION AUCTION WINNERS

Period Covered	Auction Winner	Slice of Priest Rapids Development	Auction Price Priest Rapids Development	Slice of Priest Rapids Project⁽¹⁾	Auction Price Priest Rapids Project	Total Reasonable Portion Revenues Generated⁽²⁾
10 mos. ending Oct. 2009	Macquarie Cook	11.32%	\$28,639,308	–	–	–
10 mos. ending Oct. 2009	Cargill	11.32	26,860,987	–	–	\$61,052,286
2 mos. ending Dec. 2009	Macquarie Cook	–	–	10.51%	\$ 5,727,862	–
2 mos. ending Dec. 2009	Cargill	–	–	10.51	5,372,197	29,295,284
12 mos. ending Dec. 2010	PacifiCorp	–	–	6.00	20,332,744	–
12 mos. ending Dec. 2010	Powerex	–	–	12.43	43,684,755	104,206,455
12 mos. ending Dec. 2011	Powerex	–	–	10.14	26,587,218	–
12 mos. ending Dec. 2011	Shell	–	–	10.14	27,953,652	80,721,564
12 mos. ending Dec. 2012	PPL Energy Plus, LLC	–	–	10.14	25,900,819	–
12 mos. ending Dec. 2012	Powerex	–	–	10.14	24,049,915	73,928,072
12 mos. ending Dec. 2013	TranAlta Energy Mkg	–	–	10.14	29,200,000	–
12 mos. ending Dec. 2013	Powerex	–	–	10.14	28,139,253	84,863,226

(1) Output from combined Priest Rapids Development and Wanapum Development.

(2) Total Reasonable Portion Revenues Generated represent the auction proceeds plus the remaining portion of the 30% sold to other power purchasers based on the auction price.

Reasonable Portion Revenues are available to the Electric System for the purchase of energy to meet its estimated load requirements in excess of 70% of the firm generation from the Priest Rapids Project in any given year, which are referred to as the District's Estimated Unmet Load ("EUDL"). On a planning basis, firm energy at the Priest Rapids Project equates to approximately 695 average MWs. The Electric System can then use these revenues to purchase power in the open market. The District's Electric System is then responsible to pay the costs associated with the power production to the Priest Rapids Project in proportion to the Reasonable Portion revenues taken. Total Reasonable Portion revenues used by the Electric System to meet EUDL requirements were \$11,645,038 for 2006, \$33,071,852 for 2007, \$52,341,435 for 2008, and \$32,089,771 for 2009. In 2010, 2011, 2012 and 2013, the Electric System did not need to use Reasonable Portion Revenues because it did not have an EUDL due to the higher amount of firm Wanapum Development generation that became available to the District on November 1, 2009 under the Power Sales Contracts.

Priest Rapids Project Output

The actual amounts of energy sold to the Power Purchasers for the fiscal years 2008 through 2012 are shown in the following table. During the years 2008 through 2012, the Priest Rapids Project delivered to the Power Purchasers and the District an average of 8,249,730 MWh of net energy annually. See “Coordination Agreements” and “FERC License” for a description of certain of the factors that result in the net energy figures.

Table 15
PRIEST RAPIDS PROJECT HISTORICAL ENERGY SALES
(MWh)⁽¹⁾

	2008	2009	2010	2011	2012
Gross Generation ⁽²⁾	9,394,961	8,710,613	8,193,903	10,693,863	9,901,175
Plus: Pond Transfer ⁽³⁾	76,764	(39,792)	41,451	101,146	(169,450)
Total Dissolved Gas Spill Return ⁽⁴⁾	-	-	-	8,803	44,966
Less: Rock Island Encroachment ⁽⁵⁾	(608,844)	(601,733)	(571,821)	(636,667)	(673,073)
Coordination Exchange ⁽⁶⁾	(925)	1,866	695	(6,423)	3,895
Less: Canadian Entitlements ⁽⁷⁾	(479,080)	(494,308)	(514,055)	(519,351)	(515,432)
Spill Past Unloaded Units ⁽⁸⁾	(85,699)	(7,178)	(89,599)	(67,476)	155,457
Net Energy to Purchasers	8,297,177	7,569,468	7,060,574	9,573,895	8,747,538
Max. One-Hour Production (MW)	1,799	1,782	1,767	1,779	1,756
Plant Factor ⁽⁹⁾	60%	56%	53%	69%	64%
Annual Availability Factor ⁽¹⁰⁾	93%	90%	90%	90%	86%
Disposition of Net Energy ⁽¹¹⁾					
District’s Electric System	4,000,144	3,651,136	4,036,382	5,715,363	5,337,812
PacifiCorp Electric Operations	1,135,283	732,664	629,567	170,171	194,845
Portland General Electric Co.	1,040,256	944,017	687,590	899,578	765,075
Puget Sound Energy, Inc.	664,964	374,752	78,153	55,137	79,076
City of Seattle	23,195	32,988	168,255	32,285	36,381
City of Tacoma	24,970	34,557	37,944	33,983	37,355
Avista Corporation	464,631	420,026	288,389	361,969	332,203
Cowlitz County PUD	175,134	156,109	129,527	151,008	21,358
Eugene Water & Electric Board	97,456	82,600	18,148	15,761	17,121
Other Power Purchasers ⁽¹²⁾	671,144	1,140,619	986,619	2,138,640	1,926,312
Total	8,297,177	7,569,468	7,060,574	9,573,895	8,747,538

(1) During 2010, pursuant to Commission resolution, the Priest Rapids Development and the Wanapum Development were combined into one system, the Priest Rapids Project. Prior year disclosures for the Priest Rapids Development and the Wanapum Development have been combined for comparative purposes.

(2) Excludes station service energy requirements. Variations from year to year are a result of changing fish spill requirements and Columbia River flows.

(3) Purchases of generating capability from neighboring hydroelectric projects.

(4) Energy received as offset for off-system total dissolved gas spill management coordination.

(5) Energy produced at the Wanapum Development credited to the Rock Island Project of Chelan County PUD equivalent to a portion of the energy that would have been produced at the Rock Island Project if the Wanapum Development’s reservoir had not encroached on the Rock Island Project’s tailrace.

(6) Priest Rapids Project energy exchanged by the District with parties to the Mid-Columbia Hourly Coordination Agreement.

(7) Computed power benefits produced at the Priest Rapids Project as a result of upstream Canadian storage.

(8) Spill among the Mid-Columbia Projects is reallocated based on the requests of the participants through an hourly coordination calculation.

(9) Gross generation divided by the maximum one-hour production divided by 8,760 (the hours in one year).

(10) Actual hours that the generating units of the Priest Rapids Project are available for service during the period divided by the total hours in the period.

(11) The Disposition of Net Energy between power purchasers changed in 2009 due to the Power Sales Contracts that took effect November 1, 2009 for the Wanapum Development.

(12) Cities of Forest Grove, McMinnville, and Milton-Freewater, Kittitas County PUD, Snake River Power, Clearwater Power, Idaho County Light, Kootenai Electric Cooperative, and Northern Lights, and the power auction winners.

Certain columns may not add due to rounding.

Coordination Agreements

A number of publicly and privately owned utilities in the Pacific Northwest, including the District, have joined with Bonneville, the United States Army Corps of Engineers and the United States Bureau of Reclamation in a long-term Pacific Northwest Coordination Agreement. This agreement became effective on January 4, 1965, and had an original termination date of June 30, 2003. The agreement was amended to continue until July 31, 2003. A replacement agreement began on August 1, 2003, which extends the term to 2024.

In 1973, the District entered into the Mid-Columbia Hourly Coordination Agreement to provide for moment-by-moment coordination of the seven federal and non-federal hydroelectric projects on the Mid-Columbia portion of the Columbia River, including the Priest Rapids and Wanapum Developments, with the District designated as the “central” control point under the contract. The agreement calls for continuously analyzing the total electric requirements of the seven plants and allocating generation to individual plants in a manner that results in less fluctuation of reservoirs at each dam, operation of the reservoirs at a higher average level and greater total power production. This efficient operating method increases the total generation from the Priest Rapids and Wanapum Developments, simplifies power dispatching communications, and alleviates potential technical control difficulties between the projects. This agreement was renewed for an additional 20 years ending June 30, 2017.

Transmission of Power from Priest Rapids Project

The Priest Rapids Project’s 230-kV transmission lines interconnect transmission systems of the District, Bonneville and certain Power Purchasers. These transmission lines currently have sufficient capacity to integrate fully the Priest Rapids Project’s output into the Pacific Northwest’s high-voltage transmission system. A portion of the Priest Rapids Project’s power is delivered directly to the District and certain Power Purchasers via lines owned by the respective parties, with the remainder delivered to the District and the Power Purchasers through the Bonneville transmission system. The District relies on Bonneville for transmission service of Priest Rapids Project power and transmission of purchased power, including power from the Priest Rapids Project to the Electric System. See “THE ELECTRIC SYSTEM—The Electric System’s Power Supply—Transmission.”

The District began construction work in late 2012 to build a 35.3 mile 230-kV transmission line that spans from the Rocky Ford Substation to the Columbia substation. This project is scheduled to be in construction through March 2014 and to be fully in service by mid-2014. The estimated cost is \$45.1 million. The benefits include significant reduction of transmission costs, an improved ability to deliver power from the District’s hydroelectric projects to customers, improved transmission system reliability, and improved services for load growth in the central county area.

Canadian Treaty

The Columbia River Treaty (the “Treaty”), a 60-year treaty between the United States and Canada relating to cooperative development of the water resources of the Columbia River basin, was placed in effect by an exchange of notes and ratifications on September 16, 1964. Pursuant to the Treaty, Canada has constructed three water storage facilities in Canada and is entitled, among other things, to receive one-half of the downstream power benefits defined in the Treaty. Also under the terms of the Treaty, the United States was allowed to construct Libby Dam in western Montana.

The United States and Canada have designated entities that are necessary to implement the Treaty. The U.S. entity is composed of the Administrator of Bonneville and the Division Engineer, North Pacific Division, United States Army Corps of Engineers; the Administrator is chairman. The Canadian entity is B.C. Hydro.

Operation of the Priest Rapids Project is affected by the Treaty. In general, the Treaty and its implementing agreements are implemented via the Pacific Northwest Coordination Agreement, which provides a means to coordinate the operation of all major power plants and transmission systems in the Pacific Northwest for the mutual benefit of the participants and a method to obtain and distribute the increased power benefits resulting from construction of the Canadian water storage facilities. The Treaty expires in 2024 if termination notice is supplied by either party 10 years prior to 2024. The United States entity and Canadian entity are each performing studies to

assist their respective governments in determining whether to continue, amend, or terminate the Treaty after 2024. The United States entity expects to make a recommendation to the United States by the end of 2013. As shown in Table 4, the Canadian entitlement reduces the net energy available for the Priest Rapids Project. The Canadian entitlement is a result of the Canadian improvements to the upstream storage.

FERC License

On November 4, 1955, the Federal Power Commission (now FERC) issued a 50-year license to the District authorizing the construction, operation, and maintenance of the Priest Rapids and Wanapum Developments. Upon expiration of the original license on October 31, 2005, the District operated the Priest Rapids Project under annual licenses. On April 17, 2008, FERC issued a new 44-year license for the Priest Rapids Project (the “License”), subject to the terms and conditions of the 401 Water Quality Certification issued by the State of Washington Department of Ecology (“Ecology”), the Section 18 Fishway Prescriptions and incidental take statements submitted by National Oceanic and Atmospheric Administration (“NOAA”) Fisheries and U.S. Fish and Wildlife Service, and the Salmon and Steelhead and Hanford Reach settlement agreements described below.

Fish, Wildlife and Water Quality

The License requires mitigation and enhancement measures including: operation of the Wanapum fish bypass and spill to improve downstream passage of juvenile salmon and steelhead; construction of a top-spill bypass for the Priest Rapids Dam; improvements to upstream fish passage facilities; sluiceway spills for fish passage; and implementation of numerous facilities, management plans and monitoring to protect and enhance wildlife and associated habitat. The capital cost of these measures for years 2013-2015 is estimated at \$46.3 million.

Section 401 Water Quality Certification

As a condition to obtaining the License, the District obtained a certification from Ecology under Section 401(a)(1) of the Clean Water Act (“CWA”). The conditions in the certification are incorporated into the License and require that the Priest Rapids Project be operated pursuant to the Salmon and Steelhead Agreement (as described under “Regulatory Proceedings Affecting the Developments”) and native resident fish management plans. The certification requires the establishment of groups for coordination and implementation of the requirements under the Salmon Agreement, as well as implementation of measures to determine attainment of specified biological objectives. These measures include the requirement to provide funds (not to exceed \$1,500,000) to renovate the existing Columbia Basin Hatchery facility to ensure stable operations at current capacity for the term of the License.

Recreation Resources

The Priest Rapids Project is an important regional recreation resource. The District supports the development of public recreation facilities when implemented in the broader public interest that do not interfere with operations of the Priest Rapids Project or conservation objectives. The District developed a Recreation Resource Management Plan as part of the relicensing application. At the Wanapum Development, there are 23 developed and undeveloped recreation sites, including boat launches, campgrounds, picnic areas, and the Wanapum Dam Heritage Center, located at the dam. At the Priest Rapids Development, there are 12 developed and undeveloped recreation sites, including boat launches, campgrounds, and picnic areas. A total of \$22.4 million is budgeted for recreation improvements during 2013-2015, as required by the License. In addition, the License requires the District to file and implement a shoreline management plan with FERC to protect the scenic quality of the mid-Columbia River. The shoreline management plan was approved in April 2013. Implementation will initiate in mid-2013 and will include compliance activities associated with non-project use of project lands. A component of the shoreline management plan is to plan for the future use of Crescent Bar Island. Implementation of the plan is subject to the outcome of on-going litigation with previous leaseholders. See “LITIGATION.”

Cultural Resources

During relicensing of the Priest Rapids Project, the District initiated the cultural resource identification survey, which identified more than 350 new archaeological sites and several hundred isolated artifacts, bringing the total number of identified cultural resources within the Priest Rapids Project boundary to 1,297. The Programmatic Agreement for Cultural Resources (“PA”) was executed in 2007, and outlined specific actions related to cultural resources preservation and management, each with target dates. The focus of the PA is evaluation of all cultural resources to determine if they are eligible for the National Register of Historic Places, identify effects to significant resources, and develop comprehensive treatment plans to mitigate adverse effects. A Historic Properties Management Plan (“HPMP”) was developed that provides guidelines for long-term management of the District’s cultural resources. Fieldwork to meet requirements of the PA has determined that approximately 397 sites are eligible, 651 are not eligible, and 249 are considered eligible pending permission from the State land manager to conduct test excavations. The National Register-eligible sites are undergoing further analysis. Twelve sites received major structural remediation of eroding shoreline for permanent protection. Over \$7.5 million is budgeted for 2013 - 2015 for cultural resource management.

Wanapum Agreement

The License required the District to develop a new agreement with the Wanapum Indians committing to the “identification, protection and management of cultural resources, gravesites, and relics at the Priest Rapids Project which are significant to the Wanapum Indians.” The New Wanapum Heritage Center (“NWHC”) is being constructed and will be a facility dedicated to the protection, preservation, interpretation and perpetuation of the Wanapum culture and the cultural resources. The NWHC will house the Museum, Repository, and Living Culture Program on a site near Priest Rapids Dam. The total estimated cost of this project from 2013 - 2015 is \$14.6 million.

Yakama Nation Agreement

In 2007, the District entered into an agreement with the Confederated Tribes and Bands of the Yakama Nation (the “Yakama Nation”) to settle several issues including previous lawsuits, claims, allegations, filings, and other actions by the Yakama Nation against the District. The agreement expires at the end of the License. The benefit to the Yakama Nation is the financial equivalent of 20 aMW for 2007-2009, 15 aMW for 2010-2015 and 10 aMW throughout the term of the agreement. After 2015, the Yakama Nation can request to have actual physical power delivered. The Yakama Nation is responsible to pay the Priest Rapids Project costs associated with producing the benefit received (either financial or physical delivery).

Considerations to be provided by the Yakama Nation to the District include providing the District with the right of first refusal to participate in the development of new generation resources, to cooperatively develop Pacific lamprey and white sturgeon management plans with the District, and to represent itself on committees, subcommittees and groups involved with implementation of the various agreements associated with the Priest Rapids Project and the License requirements.

The agreement went into effect on July 1, 2007. The net payments to the Yakama Nation totaled \$422,898 for 2012, \$825,668 for 2011, and \$2.4 million for 2010. These costs are included in Annual Power Costs. From 2010 through 2015, the District values the power allocation on behalf of the Yakama Nation and pays the monthly net revenues by multiplying the power allocation (15 aMW through 2015) by the Intercontinental Exchange (“ICE”) Daily Power Indices for the Mid-Columbia at peak and off-peak for the month less the average annual melded power costs for the Priest Rapids Project for the prior calendar year and any costs associated with the marketing and administration of the power allocation. The projected annual cost for this agreement from 2014 to 2018 is approximately \$2.0 million.

Regulatory Proceedings Affecting the Developments

Advanced Turbine Replacement. As discussed under “Rehabilitation Program—Priest Rapids Project,” FERC’s 2004 order authorizing the installation of advanced turbines at the Wanapum Dam allows staged installation of new, more efficient turbines. The District is replacing all ten of the existing turbines at Wanapum Dam. The new

turbines have increased power output and efficiency, and include features intended to improve the survival of fish. The advanced turbine is an important measure projected to improve conditions for fish and water quality within the Wanapum Development's project area. Nine Turbine Units have been successfully replaced. The District expects to complete the tenth and final turbine by October 2013. The estimated cost of this program from 2013 through completion is \$11.6 million.

Allocation of Output. Federal legislation adopted in 1954, Public Law 83-544 ("PL 83 544"), requires the District, among other things, to offer a "reasonable portion" of the output of the Priest Rapids Project for sale in neighboring states. In 1998, in response to a complaint filed by several electric cooperatives seeking an allocation of power under a new license, FERC issued an order regarding distribution of the Priest Rapids Development power post 2005 and the Wanapum Development power post 2009. FERC ruled that the licensee can retain 70% of the Priest Rapids Project's firm and non-firm power. The remaining 30% is designated as the "reasonable portion," and, pursuant to the order, must be sold in a fair, equitable and nondiscriminatory manner, pursuant to market based principles and procedures with a preference in the marketing of such power being given to the utilities and the Power Purchasers that participated in the PL 83 544 proceeding. See "Power Sales Contracts."

Endangered or Threatened Species of Fish. In 1997 and 1999, the Upper Columbia River ("UCR") Steelhead and Spring Chinook, respectively, were listed as endangered. In 1998, the UCR bull trout was listed as threatened. Bull trout occurrences in the Priest Rapids Project area consist of extremely small numbers frequenting the upper reaches of the Wanapum reservoir. The ESA makes it unlawful for any person subject to the jurisdiction of the United States to "take" any endangered species which, under the ESA, includes an intentional or negligent act that will harm or harass, or that creates the likelihood of injury to a species by significantly disrupting normal behavior patterns. Violations of the ESA can be enforced by governmental and citizen suits. There are both civil and criminal penalties. NOAA Fisheries, under certain circumstances, has the power to approve any "incidental taking" of a listed species. NOAA Fisheries can only approve the action if it determines, after required consultation, that the action is not likely to jeopardize the continued existence of any listed species or result in the destruction or adverse modification of its critical habitat.

During its environmental and administrative review of the District's relicensing application, FERC initiated ESA consultation with NOAA Fisheries for spring Chinook and steelhead and with the U.S. Fish and Wildlife Service for bull trout. These reviews resulted in issuance of Biological Opinions and Incidental Take Statements for these ESA listed species affected by the Priest Rapids Project and incorporated protection, mitigation and enhancement measures as requirements of the new license issued in 2008. The District continues to interact with these regulatory agencies for the implementation of these measures.

Federal Project ESA Litigation. With several salmon species listed under the ESA, Bonneville, the U.S. Bureau of Reclamation, and the U.S. Army Corps of Engineers have undertaken and are implementing certain measures to protect salmon. These regulatory requirements are required by the ESA in order for these federal agencies to avoid actions that would jeopardize the listed species. Some of these required measures affect river operations on the Snake and Columbia Rivers. Even though the Priest Rapids Project is located upstream from the confluence of the Snake and Columbia Rivers, some measures, such as substantial seasonal flow augmentations, do affect that portion of the Columbia River where the Priest Rapids Project is located. In particular, the flow augmentations cause over-generation in the spring and early summer when there is an abundance of hydroelectric generation and the value of such energy therefore is low, and a reduction of generation in the winter when the energy is needed and the price of replacement energy therefore is high.

Hanford Reach Fall Chinook Protection Agreement. In 2004, the Hanford Reach Fall Chinook Protection Agreement was signed by Grant, Chelan, and Douglas County PUDs, Bonneville, the Washington Department of Fish and Wildlife, NOAA Fisheries, Yakama Nation, U.S. Fish and Wildlife Service and the Colville Confederated Tribe. The agreement replaced an existing agreement by combining the spawning period flow regime with the flow re-shaping program developed from 1999-2003 to reduce stranding and entrapment of fall Chinook fry. The agreement involves close coordination among the District, Bonneville, and Chelan and Douglas County PUDs to provide a flow regime that protects Fall Chinook from spawning through emergence and early rearing.

Salmon and Steelhead Agreement. In 2006, the District entered into an agreement (the "Salmon and Steelhead Agreement") with the U.S. Department of Interior, U.S. Fish and Wildlife Service, NOAA Fisheries, the

Washington Department of Fish and Wildlife, the Yakama Nation, and the Confederated Tribes of the Colville Reservation, for the purpose of resolving all issues between the District and the other signatories related to anadromous salmonid fish species in connection with the License. The Salmon and Steelhead Agreement constitutes a comprehensive and long-term adaptive management program for the protection, mitigation, and enhancement of fish species which pass or may be affected by the Priest Rapids Project.

The District is obligated to establish separate restricted funds (the “Habitat funds”) into which the District will deposit payments for further distribution in accordance with the requirements of the Salmon and Steelhead Agreement and the Biological Opinion. The Priest Rapids Coordinating Committee (“PRCC”) oversees the distribution of the Habitat funds created through the Salmon and Steelhead Agreement. The voting members of the PRCC include the District, the U.S. Fish and Wildlife Service, NOAA Fisheries, Washington Department of Fish and Wildlife, the Confederated Tribes of the Colville Reservation, and the Yakama Nation. The Habitat funds cannot be spent without the unanimous consent of all voting members. All interest earned by the Habitat funds increase the balance of these funds and is not recognized as income by the District. The funds are used for the protection and restoration of habitats along the mainstem and tributaries within the Upper Columbia River watershed and are intended to compensate for 2% of the unavoidable mortality to salmonids due to the operation of the Priest Rapids Project. The District anticipates funding the Habitat funds through the License term. The District’s required contributions to the Habitat funds are comprised of a fixed portion and a portion which is variable based on annual salmonid mortality within the Priest Rapids Project.

The District’s total contributions to the Habitat funds for the years ended December 31, 2012 and December 31, 2011, equaled \$3,164,292 and \$5,222,369, respectively. The District expects to contribute approximately \$13.4 million during the period 2013 through 2016.

Draw-Down and Dam Removal Proposals. Removal or drawdown of dams has not been a significant issue in the case of the mid-Columbia River. The District believes that it is highly unlikely that any federal or state regulatory agency would order dam removal or draw-down of the Priest Rapids or Wanapum Developments in connection with any pending or future ESA listings.

Potential Effects on District of ESA Proceedings. The District has committed substantial resources to mitigate the impacts of the Priest Rapids Project on anadromous fish, including species listed as threatened or endangered. Nonetheless, it is possible under the ESA that the continued operation of the Priest Rapids Project, at least during certain periods each year, could be jeopardized. The Biological Opinion contained numerous measures including interim spill and bypass system requirements, which have a direct effect on power generation at the Priest Rapids Project. While ESA litigation has been avoided, there is some future risk of adverse court rulings.

Rehabilitation Program – Priest Rapids Project

In the early 1980s, the District began a program of equipment renewal and rehabilitation to improve generating unit availability and overall plant operation to minimize unscheduled outages of generating units due to generator winding failures.

The major programs at the Priest Rapids Development include generating unit restoration, generating unit equipment improvements, powerhouse improvements, power plant modernization, and communication/control system improvements. The District began replacement of the generator stator core and windings in 1986 and completed the last unit in 1998. Rehabilitation work on the hydraulic governors and wicket gate servos and replacement of the main excitation systems (completed in 1995) and main circuit breakers (completed in 1998) have also been performed.

All ten of the Wanapum Development generators were rewound between 1983 and 1994. During the rehabilitations, problems were discovered with cracking of the turbine trunnion keyways. Initial repairs on the first eight units were not successful as the cracking reoccurred after several years of operation; however the last two units were successfully repaired using a different method. In addition to the cracking of the turbine trunnion keyways, cracking of the turbine blades themselves was discovered to be occurring. The cracks were found on both the pressure and suction sides of the blades and extended into the blade root area in all cases. In 1996 the District began working on designs for replacing the turbines at the Wanapum Development. The District received approval from FERC for

license amendments to install and operate new advanced turbines. New turbines have been successfully installed for nine of the ten Wanapum units with the most recent being placed in service in November 2012. The District anticipates completing the remaining unit in October 2013. As of December 31, 2012, the cost of the remaining turbines to be replaced is estimated at \$11.6 million.

To get full use of the new turbines, the District is also replacing and upgrading the generators at the Wanapum Development. In 2009, a contract was awarded to Alstom Hydro US, Inc. for \$150 million to upgrade all ten generators at Wanapum Development. The third generator was placed in service in December 2012. The on-site construction is scheduled through January 2018. The existing generators are currently rated at 109.25 megavolt-amperes (“MVA”). The new generators will have a nameplate rating of 128.6 MVA, an increase of 17.7%. As of December 31, 2012, the cost of replacing the remaining seven generators is estimated at \$106.6 million.

In addition to the Wanapum turbine and generator replacement project, the District is initiating design and engineering work on turbine life extension/replacement and generator rewinds for the Priest Rapids Development. Initial modeling has begun and the District expects to be working through the design and contracting process in 2014, with turbine upgrade installation at the Priest Rapids Development beginning in 2016 and completed by 2025.

Main generating unit circuit breakers have been replaced at the Wanapum and Priest Rapids Developments. From 2005-2009 the five main step-up transformers were replaced at the Priest Rapids Development. The main step-up transformers are also being replaced at the Wanapum Development beginning in 2012. The hydraulic governors at both plants have been approved for upgrades to digital hydraulic models. This work will follow the generator upgrade projects at both plants and will also include upgraded generator protection and unit control systems. Over the next five years the plant 600 V and 13.2 KV switchgear is scheduled for replacement at both developments. All major plant cranes have been rebuilt, and spillway gates have been rehabilitated. A fiber optic data/communications cable has been installed between the Wanapum and Priest Rapids Developments to replace the existing microwave path as the primary link. The District continues to work on rehabilitation of station service (air, water, oil and electric) systems for both plants.

During a FERC inspection in 1999, the Priest Rapids Development spillway gate trunnion thrust washers were noted to have severe cracking. Installation of the new bearings and thrust washers was finished at the Priest Rapids Development in 2004. The Wanapum spillway gate trunnions contained the same type of bearings and thrust washers. Cracking was observed in the washers in 1999 and bearings during inspection. Replacement of the bearings and washers was included as part of the gate rehabilitation contract that started in the fall of 2004. This spillway gate trunnion work at the Wanapum Development was completed in the spring of 2011. Following the trunnion work, the Wanapum spillway gates are scheduled for new paint. Replacing the paint on the Wanapum spillway gates is a major undertaking because of their size. The gates are 50 feet wide by 68 feet tall and the original paint contains lead. The Wanapum spillway gate painting will begin in late 2013 and is expected to be completed in 2019. In addition to the painting, the District is continuing to determine if modifications to the spillway gates are necessary to address the recently updated seismic and structural requirements.

Priest Rapids Project Seismicity Study

The District is in the process of updating the Priest Rapids Project seismicity report. Over the last five years a Probabilistic Seismic Hazards Analysis (“PSHA”) has been completed for the mid-Columbia River PUD’s. The PSHA Report was completed in February 2012, and has been approved by the FERC. The PSHA provides the seismic input used to complete site specific structural calculations for the Priest Rapids Project features. Currently, the District is applying the results of the PSHA to several project features (embankments, gates, concrete structures, etc.) to determine if the features meet current seismic criteria. At the current time the only anticipated modification is to the far west embankment section to the Priest Rapids Dam. Preliminary estimates for this modification are in the range of \$20-30 million and this project is in the budget for remediation. Additionally, there is a possibility that a section of the east embankment at Wanapum Dam may need remediation at an estimated cost of \$100 million. However, there is a low probability that this remediation would be needed so this project is not currently in the budget. It is believed that any other seismic remediation work will be minor (anchoring equipment and other small enhancements) and will be budgeted when the scope is determined. The seismic evaluation of the project features is anticipated to be completed by year end 2015.

Estimated Capital and Financing Requirements

The District projects that the total cost of the capital program at the Priest Rapids Project during the period 2013 through 2016 will be approximately \$454 million, as shown in the table below, which will be financed by prior, current, and future bond proceeds of the Priest Rapids Project. The 2013 Priest Rapids Bonds will fund a small portion of capital improvements in 2013 and all of the projected Priest Rapids Project capital improvements in 2014. The District's capital program at the Priest Rapids Project is expected to begin to decline in 2018 as the bulk of significant projects, such as Wanapum generators and license requirements, are forecasted to be largely completed in 2017. Improvements at the Priest Rapids Project are designed to ensure optimal performance of these large, long lived assets and to comply with the License.

Table 16
PRIEST RAPIDS PROJECT
2013-2016 FORECAST CAPITAL PROGRAM EXPENDITURES

Turbine/Generator Restoration	\$ 176,196,329
License Implementation	127,842,286
Powerhouse Improvements	114,527,068
Miscellaneous ⁽¹⁾	35,640,398
	<hr/>
	\$ 454,206,081

(1) Includes buildings and property improvements, computer hardware and software, tools, equipment, security and communication/control systems improvements.

Operating Results

The following table shows actual operating results for the Priest Rapids Project for the fiscal years 2008 through 2012. Revenues from the Power Purchasers and the District's Electric System are currently equal to the cost of power from the Priest Rapids Project. Such cost of power is a function of operating expenses, annual debt service and coverage requirements on the Priest Rapids Project parity bonds and reserve requirements imposed by the Priest Rapids Project Bond Resolution and the Power Sales Contract (which went into effect on November 1, 2005 for the Priest Rapids Development and November 1, 2009 for the Wanapum Development) and the Wanapum Development 1959 Power Sales Contracts. The Power Sales Contracts established the costs to be included in the cost of power from the Priest Rapids Project. This table differs from the financial statements in Appendix C and is designed to show compliance with the debt service coverage requirements in the Bond Resolution. See APPENDIX A—“SUMMARY OF CERTAIN PROVISIONS OF THE BOND RESOLUTION.”

Table 17
PRIEST RAPIDS PROJECT OPERATING RESULTS
(\$000)

	2008	2009	2010	2011	2012
Operating Revenues					
Sales of Power ⁽¹⁾	\$ 119,874	\$ 110,376	\$ 133,945	\$ 140,183	\$ 135,338
Interest and Other Income ⁽²⁾	<u>6,393</u>	<u>3,484</u>	<u>5,955</u>	<u>7,864</u>	<u>8,677</u>
Total Revenues and Other Income	\$ 126,207	\$ 113,860	\$ 139,900	\$ 148,047	\$ 144,015
Operating Expenses					
Generation	\$ 37,923	\$ 26,799	\$ 21,966	\$ 22,277	\$ 23,462
Transmission	1,980	2,060	1,985	2,232	1,516
Administrative and General	30,065	16,308	15,435	14,895	15,396
License Compliance and Related Agreements ⁽³⁾	--	18,362	25,260	25,050	19,597
Taxes	<u>1,779</u>	<u>1,735</u>	<u>1,398</u>	<u>2,065</u>	<u>1,827</u>
Total Operating Expenses	\$ 71,747	\$ 65,264	\$ 66,044	\$ 66,519	\$ 61,798
Net Revenues	\$ 54,460	\$ 48,596	\$ 73,856	\$ 81,528	\$ 82,217
Transfer Requirements ⁽⁴⁾	--	6,000	--	--	--
Unused bond proceeds refunded	--	--	16	--	--
Excess Available in Supplemental R&R Fund	\$ 8,189	\$ 8,183	\$ 8,196	\$ 10,228	\$ 11,968
Remaining Net Revenues Available for Debt Service on Parity bonds	\$ 62,649	\$ 62,779	\$ 82,068	\$ 91,756	\$ 94,185
Debt Service on Parity Bonds	\$ 54,551	\$ 54,642	\$ 56,930	\$ 80,837	\$ 80,380
Debt Service Coverage on Parity Bonds ⁽⁵⁾	1.15x	1.15x	1.44x	1.14x	1.17x
Net Energy Output (MWh) ⁽⁶⁾	8,297,177	7,569,468	7,060,574	9,573,895	8,747,538
Average Cost (\$/MWh) ⁽⁷⁾	\$14.44	\$14.58	\$18.97	\$14.64	\$15.47

(1) Revenues from all Power Purchasers including the Electric System (Annual Power Costs).

(2) Interest and other nonoperating income on various funds of the Priest Rapids Project.

(3) The District began to account for these FERC license related expenses separately in 2009. Previously included in Administrative and General expenses and Generation expenses.

(4) Represents amounts transferred to the 1956 Renewal and Replacement Fund, 1963 Reserve and Contingency Fund and the 1963 Bond Reserve Account or to be credited to power costs. In 2009, the balances represent the refunding of the 1963 Reserve and Contingency Fund to the power purchasers as set forth in the original power sales contract that expired on October 31, 2009.

(5) Annual charges for sales of power are set at levels sufficient to produce revenues to meet the debt service coverage requirement, which is 1.15x. For 2011, the debt service coverage fell below the 1.15x requirement in the bond resolutions for the outstanding Priest Rapids parity bonds due to the change from the requirement that monthly deposits be made into the Bond Fund for debt service to the requirement that debt service be deposited on or prior to the due date. The District has recalculated the debt service calculations for 2010-2012 from the calculations included in the District's financial reports.

(6) Run-off was 92% of average in 2008, 82% of average in 2009, 81% of average in 2010, 127% of average in 2011 and 122% of average in 2012.

(7) Revenues from sales of power divided by net energy output. For 2009, Sale of Power was reduced by a \$6 million refund to Power Purchasers from a reserve account as of end of the original power sales contract in 2009. This one time refund was added back into sales of power for the calculation of Average Cost.

Certain columns may not add due to rounding.

Monthly payment by the Power Purchasers and the Electric System of their respective shares of Annual Power Costs is required by the Power Sales Contracts, even if no power and energy are actually delivered. Annual Power Costs are estimated one year in advance and are payable in equal monthly portions of such estimate. Payments are adjusted annually to reflect actual costs.

The District expects that the average cost of power from the Priest Rapids Project will increase over the next five years, primarily as a result of increased debt service, rising to approximately \$20 per MWh under average water conditions.

Debt Service Requirements for the Priest Rapids Project

The following table gives debt service requirements for the outstanding Priest Rapids Project bonds, including the 2013 Priest Rapids Bonds. A portion of the federal credit payments the District should receive for a portion of the 2010 Priest Rapids Project Bonds and the 2012 Priest Rapids Project Bonds has been reduced as a result of the Federal sequestration. The IRS has announced that the reduction will be 8.7% through September 30, 2013, at which time it could change.

Table 18
PRIEST RAPIDS PROJECT TOTAL DEBT SERVICE REQUIREMENTS⁽¹⁾

Year ⁽²⁾	Outstanding Priest Rapids Project Bonds ⁽³⁾			Aggregate Debt Service on Priest Rapids Project Bonds
	Priest Rapids Development	Wanapum Development	Priest Rapids Project	
2013(4)	\$ 19,649,871	\$ 23,676,879	\$ 31,129,875	\$ 74,456,625
2014	18,858,538	22,430,297	38,138,896	79,427,731
2015	17,193,022	20,796,465	39,304,998	77,294,485
2016	17,190,413	20,785,018	39,303,169	77,278,600
2017	17,171,429	20,752,538	39,284,993	77,208,960
2018	16,140,289	19,881,738	39,355,545	75,377,572
2019	14,747,322	17,814,015	38,883,457	71,444,794
2020	14,727,543	17,799,644	38,823,725	71,350,912
2021	14,725,029	17,801,419	38,738,467	71,264,915
2022	12,893,000	15,862,529	36,622,056	65,377,585
2023	12,884,134	15,860,054	36,561,720	65,305,908
2024	10,442,915	15,846,846	32,574,325	58,864,086
2025	10,421,906	15,842,369	32,493,515	58,757,790
2026	10,411,787	15,836,097	32,423,975	58,671,859
2027	10,417,278	15,819,797	119,783,367(5)	146,020,442
2028	10,405,754	15,817,676	32,256,388	58,479,818
2029	10,385,588	15,806,801	32,054,520	58,246,909
2030	10,379,879	18,352,347	29,320,221	58,052,447
2031	9,886,727	17,940,360	29,114,255	56,941,342
2032	6,338,410	16,592,693	70,466,273(6)	93,397,376
2033	6,334,397	16,579,744	26,901,568	49,815,709
2034	3,977,861	16,565,051	26,677,967	47,220,879
2035	3,966,509	16,551,315	26,436,072	46,953,896
2036	3,965,527	16,532,117	24,731,746	45,229,390
2037	--	16,516,810	24,480,171	40,996,981
2038	--	16,501,644	24,208,253	40,709,897
2039	--	9,668,927	26,819,197	36,488,124
2040	--	9,656,989	26,531,821	36,188,810
2041	--	9,648,363	9,890,375	19,538,738
2042	--	9,636,832	9,872,769	19,509,601
2043	--	9,621,356	9,866,658	19,488,014
Total	\$283,515,128	\$508,794,734	\$1,063,050,337	\$1,855,360,195

(1) Columns may not add due to rounding.

(2) Based on a calendar year, including January 1 and July 1 payments made in that year.

(3) Before federal credit payments.

(4) Includes the January 1, 2013 payment already made.

- (5) A portion of this represents the \$90,000,000 of New Clean Renewable Energy Bonds issued by the District in 2010, and the District has covenanted to deposit sinking fund installments into a subaccount in the Principal and Bond Retirement Account no later than January 1 through 2027 sufficient to pay such bonds on January 1, 2027.
- (6) A portion of this represents the \$42,395,000 of New Clean Renewable Energy Bonds issued by the District in 2012, and the District has covenanted to deposit approximately equal sinking fund installments into a subaccount in the Principal and Bond Retirement Account no later than January 1 in the years 2013 through 2032 sufficient to pay such bonds on January 1, 2032.

ECONOMIC AND DEMOGRAPHIC INFORMATION

Grant County (the “County”) is the fourth largest county in the State by land area, encompassing a total of 2,681 square miles. Within the County are 15 incorporated cities and towns. Moses Lake is the largest city with an estimated 2012 population of 20,950 and Ephrata, the County seat, is the second largest with a 2012 population of 7,750. The County’s total population has grown from 74,698 in 2000 to 91,000 in 2012, an increase of over 20%. Population density in the County in 2012 was 33.96 persons per square mile ranking it 21st of the 39 counties in the State. The total civilian labor force in the County in 2012 is 40,890.

The County’s economy is based on diversified agriculture, food processing, manufacturing, hydroelectric generation projects and a strong service sector. The County’s prominence in agriculture is due in large part to the U.S. Bureau of Reclamation’s Columbia Basin Irrigation Project, which has turned raw land into high yield farmland through irrigation. Recently, several technology data centers have opened in the County.

Following are economic indicators for the County.

Table 19
GRANT COUNTY
SELECTED ECONOMIC INDICATORS

	Population (1)	Per Capita Personal Income (2)	Taxable Retail Sales (\$000) (3)	Value of Building Permits (\$000) (4)	Personal Income (\$000) (2)
2012	91,000	—	\$ 1,588,877	\$ 65,127	—
2011	90,100	\$30,999	1,491,165	51,426	\$2,829,145
2010	89,120	30,148	1,215,315	72,488	2,704,290
2009	86,100	29,145	1,225,954	41,432	2,545,522
2008	84,600	30,630	1,551,866	76,211	2,601,806
2007	82,500	27,439	1,537,951	121,243	2,267,736
2006	80,600	25,016	1,107,853	78,601	2,027,185
2005	79,100	24,138	872,602	78,572	1,919,739
2004	78,300	24,109	800,596	66,819	1,898,176
2003	77,100	23,453	744,458	52,264	1,828,312

(1) *Source:* Washington State Employment Security Department, Labor Market & Economical Analysis Branch; information for 2010 is from the U.S. Bureau of the Census.

(2) *Source:* Washington State Bureau of Economic Analysis; 2011 is most recent data available.

(3) *Source:* Washington State Department of Revenue.

(4) *Source:* Grant County Building Department.

Table 20
GRANT COUNTY MAJOR PROPERTY TAXPAYERS (1)

Taxpayer	Business	Assessed Valuation	% of County Assessed Valuation
REC Solar Grade Silicon, LLC	Chemical Manufacturing	\$ 531,336,260	6.38%
Microsoft Corporation	Data Center/Technology	429,588,075	5.16
Yahoo, Inc.	Data Center/Technology	189,862,515	2.28
Quincy Data Center LLC	Data Center/Technology	133,698,570	1.60
Dell Marketing LP	Data Center/Technology	93,699,000	1.12
Intuit Inc.	Data Center/Technology	61,965,075	0.74
SGL Automotive Carbon Fibers LLC	Carbon Manufacturing	60,990,875	0.73
Inflation Systems	Air Bag Products	53,854,395	0.65
Lamb-Weston BSW, LLC	Potato Products	49,472,295	0.59
J. R. Simplot	Potato Products	49,272,620	0.59
Moses Lake Industries	Chemical Manufacturing	43,762,935	0.53
Conagra Foods Lamb-Weston Inc.	Potato Products	43,278,435	0.52
BNSF Railway Company Tax Dept.	Railroads	42,972,659	0.52
Intergate Quincy LLC	Data Center/Technology	41,910,990	0.50
Columbia Colstor, Inc.	Cold Storage	40,300,395	0.48
Chemi-Con Materials Corp.	Chemical Manufacturing	32,853,955	0.39
Guardian Fiberglass Inc.	Fiberglass	32,105,005	0.39
EKA Chemicals, Inc.	Chemicals	30,615,015	0.37
National Frozen Foods Corp.	Frozen Foods	22,384,120	0.27
IAC Search & Media WA LLC	Data Center	18,249,060	0.22
Qwest Corporation Inc.	Telecommunications	17,546,908	0.21
Basic American Inc.	Potato Products	17,371,795	0.21
Oregon Potato Company	Potato Products	17,177,370	0.21
William G. and Jeannette Evans	Real Estate	15,508,755	0.19
Quincy Foods, LLC	Frozen Vegetables	14,994,585	0.18
		\$ 2,084,771,662	25.02%

(1) Total County assessed valuation for 2013 taxes is \$8,331,112,401.
Source: Grant County Assessor for tax collection year 2013.

Table 21
GRANT COUNTY MAJOR EMPLOYERS

Employer	Product/Service	Employees
Genie Industries, Inc.	Construction & Industrial Material Lifts & Aerial Work Platforms	1,250
Moses Lake School District	Education	951
Grant County Government	Government	633
The District	Electric Utility	630
Wal-Mart	General Retail & Grocery Retail	615
REC Silicon	Polysilicon Manufacturing	500
Samaritan Healthcare	Health Care	473
ConAgra Foods, Inc.	Frozen Potato Processing	460
J.R. Simplot Co.	Frozen French Fries & Dehydrated Potato Products	375
Quincy Foods, LLC	Frozen Vegetable Processing	370
Quincy School District	Education	369
Takata Corporation	Automotive Air Bags	353
Lamb Weston BSW	Frozen Potato Processing	325
Ephrata School District	Education	315
National Frozen Foods	Corn & Peas Processing	275
Moses Lake Community Health	Health Care	264
Moses Lake Clinic	Health Care	260
Moses Lake Industries, Inc.	Corporate Headquarters & Industrial Chemical	240
Washington Potato Co.	Dehydrated Potato Flake Processing	190
Big Bend Community College	Education	180
Columbia Basin Hospital	Health Care	170
Eldorado Stone	Stone and Brick Processing	125
D&L Foundry, Inc.	Manhole Cover Manufacturing	125
International Paper	Corrugated Box Manufacturing	100
Home Depot	Home Building & Repair Retail	72

Source: Grant County Economic Development Council as of June 2013.

Table 22
GRANT COUNTY RESIDENT CIVILIAN LABOR FORCE AND EMPLOYMENT (1)

	Annual Averages					
	2008	2009	2010	2011	2012	2013 ⁽²⁾
Total Labor Force	40,760	42,030	41,780	41,130	42,370	40,120
Employment	38,130	37,880	37,250	36,940	38,380	35,700
Unemployment	2,630	4,150	4,530	4,190	3,990	4,420
Unemployment Rate	6.5%	9.9%	10.8%	10.2%	9.4%	11.0%

(1) Not seasonally adjusted.

(2) Average through April 2013.

Source: Washington State Employment Security Department, Labor Market and Economic Analysis Branch.

Table 23
GRANT COUNTY NONAGRICULTURAL EMPLOYMENT (1)

NAICS Industry Title	Annual Averages					
	2008	2009	2010	2011	2012	2013 ⁽²⁾
Total Nonfarm	26,870	25,690	25,390	26,060	26,510	26,020
Total Private	19,200	17,930	17,550	18,210	18,640	17,980
Goods Producing	6,230	5,430	5,200	5,620	5,770	5,300
Services Providing	20,640	20,250	20,190	20,450	20,750	20,720
Trade, Transport. & Utilities	5,390	5,390	5,370	5,400	5,670	5,780
Information & Financial Activities	1,020	960	1,000	1,040	1,070	1,130
Government	7,680	7,760	7,840	7,850	7,870	8,040

(1) Not seasonally adjusted.

(2) Average through April 2013.

Source: Washington State Employment Security Department, Labor Market and Economic Analysis Branch.

LITIGATION

There is no litigation pending or threatened in any court (either state or federal) concerning the issuance or the validity of any Bonds, or questioning the creation, organization, existence or title to office of the members of the Commission or officers of the District or the proceedings for the authorization, execution, sale and delivery of the Bonds, or in any manner questioning the power and authority of the District to impose, prescribe or collect rates and charges for the services of the Priest Rapids Project or the Electric System.

The District is a party to pending litigation in Grant County Superior Court Case No. 08-2-01339-8 titled *General Construction Company v. Public Utility District No. 2 of Grant County, Washington*. General Construction Company alleges damages of approximately \$20 million arising from a contract dispute with the District. The District contends the allegations are without merit and intends to vigorously defend the matter. The District has asserted a counter claim for damages against General Construction Company alleging damages of approximately \$4 million. The District does not believe the outcome of this litigation will have a significant adverse impact upon the District's ability to pay the Bonds.

The District is a party to pending litigation in United States District Court Eastern District of Washington Case No. CV-11-023-JLQ titled *Kelley v. Public Utility District No. 2 of Grant County, Washington*. The District leased property to the Port of Quincy on June 5, 1962. The lease terminated on May 31, 2012. Certain residents of Crescent Bar Island occupy property owned by the District under subleases from the Port of Quincy and claim the right to continue possession of the property after termination of the lease. Any such claims conflict with the terms of the District's license issued by FERC, which does not permit residential uses on public lands. The District disputes the claims of the lessees and will vigorously defend the District's legal rights. The District does not believe the outcome of this litigation will have a significant adverse impact upon the District's ability to pay the Bonds.

The District is a party to lawsuits arising out of its normal course of business, but the District does not believe any of such litigation will have a significant adverse impact upon the District's ability to pay the Bonds.

INITIATIVE AND REFERENDUM

Under the State Constitution, the voters of the State have the ability to initiate legislation and require a public vote on legislation passed by the State Legislature through the powers of initiative and referendum, respectively. Neither power may be used to amend the State Constitution. Initiatives and referenda are submitted to the voters upon certification of a petition signed by at least 8% (initiative) and 4% (referenda) of the number of voters registered and voting for the office of Governor at the preceding regular gubernatorial election. Any law approved in this manner by a majority of the voters may not be amended or repealed by the Legislature within a period of two years

following enactment, except by a vote of two-thirds of all the members elected to each house of the Legislature. After two years, the law is subject to amendment or repeal by the Legislature in the same manner as other laws.

LIMITATIONS ON REMEDIES; BANKRUPTCY

Any remedies available to the owners of the Bonds upon the occurrence of an event of default under the Bond Resolution may be dependent upon judicial actions, which are in turn often subject to discretion and delay and could be both expensive and time-consuming to obtain. If the District fails to comply with its covenants under the Bond Resolution or to pay principal of or interest on the Bonds, there can be no assurance that available remedies will be adequate to fully protect the interests of the owners of the Bonds.

In addition to the limitations on remedies contained in the Bond Resolution, the rights and obligations under the Bonds and the Bond Resolution may be limited by and are subject to bankruptcy, insolvency, reorganization, fraudulent conveyance, moratorium and other laws relating to or affecting creditors' rights, to the application of equitable principles, and to the exercise of judicial discretion in appropriate cases. The opinion to be delivered by Foster Pepper PLLC, Seattle, Washington as Bond Counsel, concurrently with the issuance of the Bonds, will be subject to limitations regarding bankruptcy, insolvency and other laws relating to or affecting creditors' rights. The various other legal opinions to be delivered concurrently with the issuance of the Bonds will be similarly qualified. A complete copy of the proposed form of opinion of Bond Counsel is set forth in Appendix C.

A municipality such as the District must be specifically authorized under state law in order to seek relief under Chapter 9 of the U.S. Bankruptcy Code (the "Bankruptcy Code"). Chapter 39.64 RCW, entitled the "Taxing Relief Bankruptcy Act," permits any "taxing district" (defined to include public utility districts) to voluntarily petition for relief under the Bankruptcy Code. A creditor cannot bring an involuntary bankruptcy proceeding against a municipality, including the District. The federal bankruptcy courts have broad discretionary powers under the Bankruptcy Code.

TAX MATTERS

Exclusion From Gross Income. In the opinion of Bond Counsel, under existing federal law and assuming compliance with applicable requirements of the Internal Revenue Code of 1986, as amended (the "Code"), that must be satisfied subsequent to the issue date of the Bonds, interest on the Bonds is excluded from gross income for federal income tax purposes and is not an item of tax preference for purposes of the alternative minimum tax applicable to individuals.

Continuing Requirements. The District is required to comply with certain requirements of the Code after the date of issuance of the Bonds in order to maintain the exclusion of the interest on the Bonds from gross income for federal income tax purposes, including, without limitation, requirements concerning the qualified use of Bond proceeds and the facilities financed or refinanced with Bond proceeds, limitations on investing gross proceeds of the Bonds in higher yielding investments in certain circumstances, and the requirement to comply with the arbitrage rebate requirement to the extent applicable to the Bonds. The District has covenanted in the Bond Resolution to comply with those requirements, but if the District fails to comply with those requirements, interest on the Bonds could become taxable retroactive to the date of issuance of the Bonds. Bond Counsel has not undertaken and does not undertake to monitor the District's compliance with such requirements.

Corporate Alternative Minimum Tax. While interest on the Bonds also is not an item of tax preference for purposes of the alternative minimum tax applicable to corporations, under Section 55 of the Code, tax exempt interest, including interest on the Bonds, received by corporations is taken into account in the computation of adjusted current earnings for purposes of the alternative minimum tax applicable to corporations (as defined for federal income tax purposes). Under the Code, alternative minimum taxable income of a corporation will be increased by 75% of the excess of the corporation's adjusted current earnings (including any tax exempt interest) over the corporation's alternative minimum taxable income determined without regard to such increase. A corporation's alternative minimum taxable income, so computed, that is in excess of an exemption of \$40,000, which exemption will be reduced (but not below zero) by 25% of the amount by which the corporation's alternative minimum taxable income exceeds \$150,000, is then subject to a 20% minimum tax.

A small business corporation is exempt from the corporate alternative minimum tax for any taxable year beginning after December 31, 1997, if its average annual gross receipts during the three-taxable-year period beginning after December 31, 1993, did not exceed \$5,000,000, and its average annual gross receipts during each successive three-taxable-year period thereafter ending before the relevant taxable year did not exceed \$7,500,000.

Tax on Certain Passive Investment Income of S Corporations. Under Section 1375 of the Code, certain excess net passive investment income, including interest on the Bonds, received by an S corporation (a corporation treated as a partnership for most federal tax purposes) that has Subchapter C earnings and profits at the close of the taxable year may be subject to federal income taxation at the highest rate applicable to corporations if more than 25% of the gross receipts of such S corporation is passive investment income.

Foreign Branch Profits Tax. Interest on the Bonds may be subject to the foreign branch profits tax imposed by Section 884 of the Code when the Bonds are owned by, and effectively connected with a trade or business of, a United States branch of a foreign corporation.

Possible Consequences of Tax Compliance Audit. The Internal Revenue Service (the “IRS”) has established a general audit program to determine whether issuers of tax-exempt obligations, such as the Bonds, are in compliance with requirements of the Code that must be satisfied in order for interest on those obligations to be, and continue to be, excluded from gross income for federal income tax purposes. Bond Counsel cannot predict whether the IRS would commence an audit of the Bonds. Depending on all the facts and circumstances and the type of audit involved, it is possible that commencement of an audit of the Bonds could adversely affect the market value and liquidity of the Bonds until the audit is concluded, regardless of its ultimate outcome.

Bonds Not “Qualified Tax Exempt Obligations” for Financial Institutions. Section 265 of the Code provides that 100% of any interest expense incurred by banks and other financial institutions for interest allocable to tax exempt obligations acquired after August 7, 1986, will be disallowed as a tax deduction. However, if the tax exempt obligations are obligations other than private activity bonds, are issued by a governmental unit that, together with all entities subordinate to it, does not reasonably anticipate issuing more than \$30,000,000 of tax exempt obligations (other than private activity bonds and other obligations not required to be included in such calculation) in the current calendar year, and are designated by the governmental unit as “qualified tax exempt obligations,” only 20% of any interest expense deduction allocable to those obligations will be disallowed. The District has not designated the Bonds as “qualified tax exempt obligations.”

The District is a governmental unit that, together with all subordinate entities, reasonably anticipates issuing more than \$10,000,000 of tax exempt obligations (other than private activity bonds and other obligations not required to be included in such calculation) during the current calendar year and has **not** designated the Bonds as “qualified tax exempt obligations” for purposes of the 80% financial institution interest expense deduction. Therefore, no interest expense of a financial institution allocable to the Bonds is deductible for federal income tax purposes.

Original Issue Discount. The Bonds maturing in 2038 and 2041 have been sold at prices reflecting original issue discount (“Discount Bonds”). Under existing law, the original issue discount in the selling price of each Discount Bond, to the extent properly allocable to each owner of such Discount Bond, is excluded from gross income for federal income tax purposes with respect to such owner. The original issue discount is the excess of the stated redemption price at maturity of such Discount Bond over the initial offering price to the public, excluding underwriters and other intermediaries, at which price a substantial amount of the Discount Bonds of such maturity were sold.

Under Section 1288 of the Code, original issue discount on tax-exempt bonds accrues on a compound basis. The amount of original issue discount that accrues to an owner of a Discount Bond during any accrual period generally equals (i) the issue price of such Discount Bond plus the amount of original issue discount accrued in all prior accrual periods, multiplied by (ii) the yield to maturity of such Discount Bond (determined on the basis of compounding at the close of each accrual period and properly adjusted for the length of the accrual period), less (iii) any interest payable on such Discount Bond during such accrual period. The amount of original issue discount so accrued in a particular accrual period will be considered to be received ratably on each day of the accrual period, will be excluded from gross income for federal income tax purposes, and will increase the owner's tax basis in such

Discount Bond. Any gain realized by an owner from a sale, exchange, payment or redemption of a Discount Bond will be treated as gain from the sale or exchange of such Discount Bond.

The portion of original issue discount that accrues in each year to an owner of a Discount Bond may result in certain collateral federal income tax consequences. The accrual of such portion of the original issue discount will be included in the calculation of alternative minimum tax liability as described above, and may result in an alternative minimum tax liability even though the owner of such Discount Bond will not receive a corresponding cash payment until a later year.

Owners who purchase Discount Bonds in the initial public offering but at a price different from the first offering price at which a substantial amount of those Discount Bonds were sold to the public, or who do not purchase Discount Bonds in the initial public offering, should consult their own tax advisors with respect to the tax consequences of the ownership of such Discount Bonds. Owners of Discount Bonds who sell or otherwise dispose of such Discount Bonds prior to maturity should consult their own tax advisors with respect to the amount of original issue discount accrued over the period such Discount Bonds have been held and the amount of taxable gain or loss to be recognized upon that sale or other disposition of Discount Bonds. Owners of Discount Bonds also should consult their own tax advisors with respect to state and local tax consequences of owning such Discount Bonds.

Original Issue Premium. The Bonds maturing in 2024 through 2033, inclusive, have been sold at prices reflecting original issue premium (“Premium Bonds”). An amount equal to the excess of the purchase price of a Premium Bond over its stated redemption price at maturity constitutes premium on such Premium Bond. A purchaser of a Premium Bond must amortize any premium over such Premium Bond’s term using constant yield principles, based on the purchaser’s yield to maturity. The amount of amortizable premium allocable to an interest accrual period for a Premium Bond will offset a like amount of qualified stated interest on such Premium Bond allocable to that accrual period, and may affect the calculation of alternative minimum tax liability described above. As premium is amortized, the purchaser’s basis in such Premium Bond is reduced by a corresponding amount, resulting in an increase in the gain (or decrease in the loss) to be recognized for federal income tax purposes upon a sale or disposition of such Premium Bond prior to its maturity. Even though the purchaser’s basis is reduced, no federal income tax deduction is allowed. Purchasers of Premium Bonds, whether at the time of initial issuance or subsequent thereto, should consult with their own tax advisors with respect to the determination and treatment of premium for federal income tax purposes and with respect to state and local tax consequences of owning such Premium Bonds.

Reduction of Loss Reserve Deductions for Property and Casualty Insurance Companies. Under Section 832 of the Code, interest on the Bonds received by property and casualty insurance companies will reduce tax deductions for loss reserves otherwise available to such companies by an amount equal to 15% of tax exempt interest received during the taxable year.

Effect on Certain Social Security and Retirement Benefits. Section 86 of the Code requires recipients of certain Social Security and certain Railroad Retirement benefits to take receipts or accruals of interest on the Bonds into account in determining gross income.

Other Possible Federal Tax Consequences. Receipt of interest on the Bonds may have other federal tax consequences as to which prospective purchasers of the Bonds may wish to consult their own tax advisors.

Potential Future Federal Tax Law Changes. Current and future legislative proposals, if enacted into law, may directly or indirectly cause interest on the Bonds to be subject in whole or in part to federal income taxation, prevent the beneficial owners of the Bonds from realizing the full benefits of the current federal tax status of interest on the Bonds, or affect, perhaps significantly, the market value or marketability of the Bonds. Prospective purchasers of the Bonds should consult with their own tax advisors regarding the potential impact of any pending or proposed legislation or regulations.

CERTAIN LEGAL MATTERS

Legal matters incident to the authorization, issuance and sale of the Bonds by the District are subject to the approving legal opinion of Foster Pepper PLLC, Seattle, Washington, Bond Counsel. The form of the opinion of Bond Counsel with respect to the Bonds is attached as Appendix C. The opinion of Bond Counsel is given based on factual representations made to Bond Counsel, and under existing law, as of the date of initial delivery of the Bonds, and Bond Counsel assumes no obligation to revise or supplement its opinion to reflect any facts or circumstances that may thereafter come to its attention, or any changes in law that may thereafter occur. The opinion of Bond Counsel is an expression of its professional judgment on the matters expressly addressed in its opinion and does not constitute a guarantee of result. Bond Counsel will be compensated only upon the issuance and sale of the Bonds. Bond Counsel periodically serves as underwriters' counsel to the Underwriters on non-District issues.

Certain legal matters will be passed upon for the Underwriters by their counsel, K&L Gates LLP, Seattle, Washington. Any opinion of K&L Gates will be rendered solely to the Underwriters, will be limited in scope, and cannot be relied upon by investors.

CONTINUING DISCLOSURE

Basic Undertaking to Provide Annual Financial Information and Notice of Material Events

To meet the requirements of paragraph (b)(5) of United States Securities and Exchange Commission ("SEC") Rule 15c2-12 ("Rule 15c2-12"), as applicable to a participating underwriter for the Bonds, the District made the following written Undertaking for the benefit of holders of the Bonds. The District agrees to provide or cause to be provided, either directly or through a designated agent, to the Municipal Securities Rulemaking Board ("MSRB"), in an electronic format as prescribed by the MSRB, accompanied by identifying information as prescribed by the MSRB the following historical annual financial information and operating data for the prior Fiscal Year.

(1) Annual financial information and operating data of the type include in this Official Statement as generally described below ("annual financial information"); and

(2) Timely notice (not in excess of ten business days after the occurrence of the event) of the occurrence of any of the following events with respect to the Bonds:

- principal and interest payment delinquencies;
- non-payment related defaults, if material;
- unscheduled draws on debt service reserves reflecting financial difficulties;
- unscheduled draws on credit enhancements reflecting financial difficulties;
- substitution of credit or liquidity providers, or their failure to perform;
- adverse tax opinions, the issuance by the Internal Revenue Service of proposed or final determinations of taxability, Notice of Proposed Issue (IRS Form 5701—TEB) or other material notices or determinations with respect to the tax status of the Bonds;
- modifications to rights of holders of the Bonds, if material;
- Bond calls (other than scheduled mandatory redemptions of Term Bonds), if material, and tender offers;
- defeasances;
- release, substitution, or sale of property securing repayment of the Bonds, if material;
- rating changes;
- bankruptcy, insolvency, receivership or similar event of the District or Obligated Person, as such "Bankruptcy Events" are defined in Rule 15c2-12;

- the consummation of a merger, consolidation, or acquisition involving the District or the sale of all or substantially all of the assets of the District, other than in the ordinary course of business, the entry into a definitive agreement to undertake such an action or the termination of a definitive agreement relating to any such actions, other than pursuant to its terms, if material; and
- appointment of a successor or additional trustee or the change of name of a trustee, if material.

The District also will provide to the MSRB timely notice of a failure by the District to provide required annual financial information on or before the date specified below.

Type of Annual Financial Information Undertaken to be Provided

The annual financial information that the District undertakes to provide will consist of (1) the audited financial statements of the Electric System prepared in accordance with generally accepted accounting principles applicable to government entities, with regulations prescribed by the Washington State Auditor pursuant to RCW 43.09.200 (or any successor statute) and substantially in accordance with the system prescribed by the FERC; provided, that if the Electric System's financial statements are not yet available, the District shall provide unaudited financial statements in substantially the same format, and audited financial statements when they become available; (2) the outstanding long term indebtedness of the Electric System, the Priest Rapids Project and any other system of the District which provides power or capacity to the Electric System; (3) Electric System retail customers, energy sales, peak loads and revenues; (4) Electric System operating results and debt service coverage on the outstanding Parity Bonds; (5) Electric System energy requirements, resources and power costs; (6) the aggregate amount and percentage of total energy sold and of retail revenues provided by the Electric System's ten largest customers; and (7) gross generation, net energy, disposition of net energy, maximum one-hour production, average production costs, plant factor and annual availability for the Priest Rapids Project; and will be provided to the MSRB not later than the last day of the ninth month after the end of each fiscal year of the District (currently, a fiscal year ending December 31), as such fiscal year may be changed as required or permitted by State law, commencing with the District's fiscal year ending December 31, 2013.

The annual financial information may be provided in a single or multiple documents, and may be incorporated by specific reference to documents available to the public on the Internet website of the MSRB or filed with the SEC.

Amendment of Undertaking

The Undertaking is subject to amendment after the primary offering of the Bonds without the consent of any holder of any Bond, or of any broker, dealer, municipal securities dealer, participating underwriter, rating agency or the MSRB, under the circumstances and in the manner permitted by the Rule.

The District will give notice to the MSRB of the substance (or provide a copy) of any amendment to the Undertaking and a brief statement of the reasons for the amendment. If the amendment changes the type of annual financial information to be provided, the annual financial information containing the amended financial information will include a narrative explanation of the effect of that change on the type of information to be provided.

Termination of Undertaking

The District's obligations under the Undertaking shall terminate upon the legal defeasance of all of the Bonds. In addition, the District's obligations under the Undertaking shall terminate if those provisions of the Rule which require the District to comply with the Undertaking become legally inapplicable in respect of the Bonds for any reason, as confirmed by an opinion of nationally recognized bond counsel or other counsel familiar with federal securities laws delivered to the District, and the District provides timely notice of such termination to the MSRB.

Remedy for Failure to Comply with Undertaking

If the District or any other obligated person fails to comply with the Undertaking, the District will proceed with due diligence to cause such noncompliance to be corrected as soon as practicable after the District learns of that failure. No failure by the District or other obligated person to comply with the Undertaking will constitute a default in respect of the Bonds. The sole remedy of any holder or Beneficial Owner of a Bond will be to take such actions as that holder deems necessary, including seeking an order of specific performance from an appropriate court, to compel the District or other obligated person to comply with the Undertaking.

Prior Compliance with Continuing Disclosure Undertakings

The District has previously entered into continuing disclosure undertakings under Rule 15c2-12. The District has filed its annual financial information and operating data under the prior written undertakings in a timely manner. However, in connection with the Bond issuance, it was discovered that the District filed some, but not all insurer rating downgrades applicable to bonds that were outstanding at the time of the downgrades. The District did not file notice of the Financial Security Assurance Inc. downgrades in November of 2008 and May of 2009, and the Assured downgrade in November of 2009.

RATINGS

Fitch, Moody's and S&P have assigned their ratings of "AA," "Aa3," and "AA," respectively, to the Bonds. Such ratings reflect only the views of the respective rating agency and are not a recommendation to buy, sell or hold the Bonds. An explanation of the significance of such ratings may be obtained from the rating agencies. The District has furnished to each rating agency certain information and materials with respect to the Bonds. Generally, rating agencies base their ratings on such information and materials, and on investigations, studies and assumptions made by the rating agencies. There is no assurance that the ratings assigned to the Bonds will continue for any given period of time or that they will not be revised or withdrawn entirely by such rating agencies if, in the judgment of the rating agencies, circumstances so warrant. A downward revision or withdrawal of the ratings may have an adverse effect on the market price of the Bonds.

UNDERWRITING

The Underwriters have agreed, subject to certain conditions, to purchase the Bonds from the District at Underwriters' discount of \$317,266. The Underwriters' obligations are subject to certain conditions precedent, and they will be obligated to purchase all Bonds, if any Bonds are purchased. The Bonds may be offered and sold to certain dealers at prices lower than the public offering prices, and the public offering prices may be changed, from time to time, by the Underwriters. The Underwriters may offer and sell the Bonds into unit investment trusts or money market funds, certain of which may be managed or sponsored by the Underwriters, at prices lower than the public offering prices.

J.P. Morgan Securities LLC ("JPMS") has informed the District that it has entered into negotiated dealer agreements (each, a "Dealer Agreement") with each of UBS Financial Services Inc. ("UBSFS") and Charles Schwab & Co., Inc. ("CS&Co.") for the retail distribution of certain securities offerings, including the Bonds, at the original issue prices. Pursuant to each Dealer Agreement (if applicable to this transaction), each of UBSFS and CS&Co. will purchase the Bonds from JPMS at the original issue price less a negotiated portion of the selling concession applicable to any Bonds that such firm sells.

Citigroup Inc., parent company of Citigroup Global Markets Inc., an underwriter of the Bonds, has entered into a retail distribution arrangement with Morgan Stanley Smith Barney LLC. As part of the distribution arrangement, Citigroup Global Markets Inc. may distribute municipal securities to retail investors through the financial advisor network of Morgan Stanley Smith Barney LLC. As part of this arrangement, Citigroup Global Markets Inc. may compensate Morgan Stanley Smith Barney LLC for its selling efforts with respect to the Bonds.

The Underwriters may offer and sell the Bonds to certain dealers (including dealers depositing Bonds into investment trusts) and others at prices lower than the initial offering prices set forth on the inside cover page hereof,

and such initial offering prices may be changed from time to time by the Underwriters. After the initial public offering, the public offering prices may be varied from time to time.

FINANCIAL ADVISOR

Public Financial Management, Inc. has acted as financial advisor to the District in connection with the issuance of the Bonds. The financial advisor has not audited, authenticated, or otherwise verified the information set forth in this Official Statement or the other information available from the District with respect to the appropriateness, accuracy, and completeness of the disclosure of such information, and the financial advisor makes no guarantee, warranty, or other representation on any matter related to such information. Public Financial Management, Inc. is an independent financial advisory and consulting organization and is not engaged in the business of underwriting, marketing, or trading of municipal securities or any other negotiable instruments.

MISCELLANEOUS

The references, excerpts and summaries contained herein of the Bond Resolution and the Power Sales Contracts do not purport to be complete statements of the provisions of such documents and reference should be made to such documents for a full and complete statement of all matters relating to the Bonds and the rights and obligations of the owners thereof. Copies of such documents are available for inspection at the principal office of the District.

The authorizations, agreements and covenants of the District are set forth in the Bond Resolution, and neither this Official Statement nor any advertisement of the Bonds is to be construed as a contract with the owners of the Bonds. Any statements made in this Official Statement involving matters of opinion or estimates, whether or not expressly so identified, are intended merely as such and not as representations of fact.

Neither this Official Statement nor any statement which may have been made orally or in writing is to be construed as a contract with the owners of any of the Bonds.

The execution and delivery of this Official Statement has been duly authorized by the District.

PUBLIC UTILITY DISTRICT NO. 2
OF GRANT COUNTY, WASHINGTON

By /s/ Terry Brewer
President of the Commission

By /s/ Anthony Webb
General Manager

APPENDIX A

SUMMARY OF CERTAIN PROVISIONS OF THE BOND RESOLUTION

The following summary is a brief outline of certain provisions of the Bond Resolution, is not to be considered a full statement thereof and is qualified by reference to the complete Bond Resolution. Capitalized words or phrases that are not defined in this summary or conventionally capitalized have the meanings given such words or phrases in the Bond Resolution.

Certain Definitions

“Annual Debt Service” for any Fiscal Year means the sum of the amounts required to be paid into the Bond Fund, in such Fiscal Year, to pay (a) the interest due in such Fiscal Year on all outstanding Parity Bonds, excluding interest to be paid from the proceeds of the sale of bonds, (b) the principal of all outstanding Serial Bonds due in such Fiscal Year, (c) the Sinking Fund Requirement, if any, for such Fiscal Year, and (d) any regularly scheduled District Payments, adjusted by any regularly scheduled Reciprocal Payments, during such Fiscal Year. For purposes of computing Annual Debt Service on any Parity Bonds which constitute Balloon Indebtedness, it shall be assumed that the principal of such Balloon Indebtedness, together with interest thereon at the rate applicable to such Balloon Indebtedness, shall be amortized in equal annual installments over a term equal to the least of (1) 25 years or (2) the average weighted useful life (expressed in years and rounded to the next highest integer) of the properties and assets constituting the project (if any) financed out of the proceeds of such Balloon Indebtedness. In calculating the Annual Debt Service, the District may exclude the direct payment the District is expected to receive in respect of any Future Parity Bonds for which the federal government will provide the District with a direct payment of a portion of the interest from the interest portion of Annual Debt Service.

“Balloon Indebtedness” means any series or maturity of Parity Bonds that are specifically designated by a resolution as “Balloon Indebtedness.” The principal amount maturing on any date shall be the amount of Bonds scheduled to be amortized by prepayment or redemption prior to their stated maturity date.

“Bond Fund” means the Electric System Revenue Bond Fund, which shall be used solely for the purpose of paying debt service on the Bonds and any Future Parity Bonds.

“Bondowners Trustee” means a trustee appointed pursuant to the Bond Resolution.

“Derivative Facility” means a letter of credit, an insurance policy, a surety bond or other credit enhancement device, given, issued or posted as security for the District’s obligations under one or more Derivative Products.

“Derivative Payment Date” means any date specified in the Derivative Product on which a District Payment is due and payable under the Derivative Product.

“Derivative Product” means a written contract or agreement between the District and a Reciprocal Payor that has (or whose obligations are unconditionally guaranteed by a party that has) as of the date of the Derivative Product at least an investment grade rating from a rating agency, which provides that the District’s obligations thereunder will be conditioned on the performance by the Reciprocal Payor of its obligations under the agreement, and

(a) under which the District is obligated to pay, on one or more scheduled and specified Derivative Payment Dates, the District Payments in exchange for the Reciprocal Payor’s obligation to pay or to cause to be paid to the District, on scheduled and specified Derivative Payment Dates, the Reciprocal Payments;

(b) for which the District’s obligations to make District Payments may be secured by a pledge of and lien on the Gross Revenues on an equal and ratable basis with the outstanding Parity Bonds;

(c) under which Reciprocal Payments are to be made directly into the Bond Fund;

(d) for which the District Payments are either specified to be one or more fixed amounts or are determined as provided by the Derivative Product; and

(e) for which the Reciprocal Payments are either specified to be one or more fixed amounts or are determined as set forth in the Derivative Product.

“District Payment” means any payment (designated as such by resolution) required to be made by or on behalf of the District under a Derivative Product and which is determined according to a formula set forth in the Derivative Product.

“Electric System” means the electric utility and telecommunications properties, rights and assets, real and personal, tangible and intangible, now owned and operated by the District and used or useful in the generation, transmission, distribution and sale of electric energy, telecommunication services, and the business incidental thereto, and all properties, rights and assets, real and personal, tangible and intangible, hereafter constructed or acquired by the District as additions, betterments, improvements or extensions to said electric utility and telecommunications properties, rights and assets, including, but not limited to, the contract interest of the District in the P.E.C. Headworks Powerplant Project and in the Quincy Chute Project, but shall not include the Priest Rapids Project or any additions thereto, or any other generating, conservation, transmission or distribution facilities which have been or may be acquired or constructed by the District as a utility system that is declared by the Commission, at the time of financing thereof, to be separate from the Electric System, the revenues of which may be pledged to the payment of bonds issued to purchase, construct or otherwise acquire or expand such separate utility system or are otherwise pledged to the payment of the bonds of another such separate utility system of the District other than the Electric System. The Electric System does not include any interest of the District in contracts for the sale to other parties of power and energy from the Priest Rapids Project, but does include the right of the District to receive power and energy from the Priest Rapids Project. The Commission may, by resolution, elect to combine with and include as a part of the Electric System any other separate utility system of the District, provided that full provision for the payment of any outstanding indebtedness of such separate system shall first be made in the manner set forth in Section 5.3 (relating to defeasance) of the Bond Resolution or such indebtedness shall be refunded with bonds issued in accordance with the Bond Resolution.

“Future Parity Bonds” means any notes, bonds or other obligations of the District issued after the date of issuance of the Bonds which will have a lien upon the Gross Revenue of the Electric System for the payment of the principal thereof and interest thereon equal to the lien upon the Gross Revenue of the Electric System for the payment of the Bonds and the 2011 Bonds.

“Gross Revenue” means all income and revenues received by the District from the sale of electric energy through the ownership or operation of the Electric System and all other commodities, services and facilities sold, furnished or supplied by the District through the ownership or operation of the Electric System, together with the proceeds received by the District directly or indirectly from the sale, lease or other disposition of any of the properties, rights or facilities of the Electric System, and together with the investment income earned on money held in any fund or account of the District, including any bond redemption funds and the accounts therein, and federal credit payments for interest on bonds, in connection with the ownership and operation of the Electric System (but exclusive of income derived from investments irrevocably pledged to the payment of any specific revenue bonds of the District, such as bonds heretofore or hereafter refunded, or any Bonds defeased pursuant to the Bond Resolution or other bonds for which payment has been provided or which have been defeased under any similar provision of any other bond resolution of the District, and exclusive of investment income earned in any arbitrage rebate account, grants for capital purposes, assessments in any local utility district, any Reciprocal Payments and any ad valorem tax revenues).

“Net Revenue” means, for any period, the excess of Gross Revenue over Operating Expenses for such period, excluding from the computation of Gross Revenue (a) any profit or loss derived from the sale or other disposition, not in the ordinary course of business, of properties, rights or facilities of the Electric System, or resulting from the early extinguishment of debt; and (b) insurance proceeds other than proceeds to replace lost revenue.

“Operating Expenses” means the District’s expenses for operation and maintenance of the Electric System and shall include ordinary repairs, renewals, replacements and reconstruction of the Electric System, including all costs of delivering electric power and energy and payments into reasonable reserves in the Revenue Fund for items of Operating Expenses the payment of which is not immediately required, and shall include, without limiting the generality of the foregoing, costs of purchased power (including costs of power and energy required by any resolution or contract of the District to be taken by the District from the Priest Rapids Project for the account of the Electric System), costs of transmission and distribution operation and maintenance expenses, rents, administrative and general expenses, engineering expenses, legal and financial advisory expenses, required payments to pension, retirement, health and hospitalization funds, insurance premiums and any taxes, assessments, payments in lieu of taxes or other lawful governmental charges, all to the extent properly allocable to the Electric System, and the fees and expenses of the Paying Agent and Registrar. Operating Expenses shall not include any costs or expenses for new construction, interest, amortization, any allowance for depreciation and District Payments.

“Parity Bonds” means the 2011 Bonds, the Bonds and all Future Parity Bonds.

“Parity Lien Obligations” means all charges and obligations against Gross Revenues ranking on a parity of lien with Parity Bonds, including but not limited to reimbursement agreement obligations so designated, any regularly scheduled District Payments, adjusted by any regularly scheduled Reciprocal Payments, and Resource Obligations for any month such obligations are not eligible for payment as Operating Expenses. Parity Lien Obligations do not include Parity Bonds.

“Permitted Investments” means any investments or investment agreements permitted under the laws of the State of Washington as amended from time to time.

“Priest Rapids Development” means the utility system of the District acquired and constructed pursuant to the provisions of Resolution No. 313, adopted by the Commission on June 19, 1956, including a dam at the Priest Rapids Development, all generating and transmission facilities associated therewith, and all additions, betterments and improvements to and extensions of such system, but shall not include any additional generation, transmission and distribution facilities hereafter constructed or acquired by the District as a part of the Electric System , or any other utility properties of the District acquired as a separate utility system, the revenues of which may be pledged to the payment of bonds issued to purchase, construct or otherwise acquire such separate utility system.

“Priest Rapids Project” means the Priest Rapids Development and the Wanapum Development, which were consolidated pursuant to Resolution No. 8475.

“Qualified Letter of Credit” means any irrevocable letter of credit issued by a financial institution for the account of the District on behalf of the owners of any Parity Bonds, which institution maintains an office, agency or branch in the United States and as of the time of issuance of such letter of credit, is rated in one of the two highest rating categories by Moody’s Investors Service or Standard & Poor’s or their comparably recognized business successors.

“Qualified Insurance” means any noncancelable municipal bond insurance policy or surety bond issued by any insurance company licensed to conduct an insurance business in any state of the United States (or by a service corporation acting on behalf of one or more such insurance companies) which insurance company or companies, as of the time of issuance of such policy or surety bond, are rated in one of the two highest rating categories by Moody’s Investors Service or Standard & Poor’s or their comparably recognized business successors.

“R&C Fund” means the Reserve and Contingency Fund of the District created by Resolution No. 4112.

“Rate Stabilization Account” means the account within the R&C Fund.

“Reciprocal Payment” means any payment (designated as such by a resolution) to be made to, or for the benefit of, the District under a Derivative Product by the Reciprocal Payor.

“*Reciprocal Payor*” means a party to a Derivative Product that is obligated to make one or more Reciprocal Payments thereunder.

“*Refunded Municipals*” means pre-refunded municipal obligations meeting the following conditions: (i) (a) the obligations are not callable prior to maturity, (b) the obligations are callable prior to maturity and the issuer has foregone the right to call the obligations and the obligations are irrevocably escrowed to maturity, or (c) the escrow agent or trustee has been given irrevocable instructions concerning calling and redemption; (ii) the obligations are irrevocably secured by cash or non-callable Government Obligations which may be applied only to interest, principal, and premium payments of such bonds; (iii) the principal and interest of the Government Obligations (plus any cash in the fund) are sufficient to meet the liabilities of the obligations; (iv) the Government Obligations serving as security for the obligations are held by an escrow agent or a trustee; and (v) the Governmental Obligations are not available to satisfy any other claims, including those against the trustee or escrow agent.

“*Reserve Fund*” means the debt service reserve account, which shall secure the payment of the principal of and interest on the Bonds and may, at the District’s option, secure the payment of the principal of and interest on one or more series of Future Parity Bonds.

“*2011 Reserve Fund*” means the debt service reserve account, which shall secure the payment of the principal of and interest on the 2011 Bonds and may, at the District’s option, secure the payment of the principal of and interest on one or more series of Future Parity Bonds.

“*Reserve Fund Requirement*” means with respect to the Bonds and any Future Parity Bonds secured by the Reserve Fund an amount equal to the least of (a) 125% of average Annual Debt Service, (b) maximum Annual Debt Service or (c) 10% of the initial principal amount of a series of bonds. Such Reserve Fund Requirement may be recalculated and determined from time to time. The resolution authorizing Future Parity Bonds may establish a separate debt service reserve fund for any such Future Parity Bonds and set forth the reserve fund requirement for such bonds or provide that some or all of such Future Parity Bonds be secured by the Reserve Fund. If the Reserve Fund Requirement applicable to any Future Parity Bonds includes a calculation of Annual Debt Service, the resolution authorizing such Future Parity Bonds shall establish the method to be used for calculating interest on any Variable Rate Bonds for such purpose.

“*Resource Obligation*” means an obligation of the District to pay the following costs associated with a resource from Gross Revenues as (a) Operating Expenses for any month in which any power and energy or other goods and services from such resource were made available to the Electric System during such month (regardless of whether or not the Electric System actually scheduled or received energy from such resource during such month) and (b) at all other times as an indebtedness of the Electric System payable from Gross Revenues on a parity of lien with Parity Bonds and any Parity Lien Obligations:

(i) costs associated with facilities or resources for the generation of power and energy or for the conservation, transformation, transmission or distribution of power and energy (including any common undivided interest therein) hereafter acquired, purchased or constructed by the District and declared by the Commission to be a separate system, which such costs shall include but are not limited to costs of normal operation and maintenance, renewals and replacements, additions and betterments and debt service on the bonds or other obligations of such separate system but shall exclude costs paid or to be paid from the proceeds of the sale of bonds or other obligations of such separate system, or

(ii) costs associated with the purchase of energy, capacity, capability, reserves, conservation or services under a contract.

“*Serial Bonds*” means Parity Bonds other than Term Bonds.

“*Term Bonds*” means Parity Bonds of any principal maturity for which mandatory sinking fund payments are required.

“2011 Bonds” means the Electric System Revenue and Refunding Bonds, Series 2011-I authorized by Resolution No. 8572 of the District.

“Wanapum Development” means the second stage of the Priest Rapids Hydroelectric Project (F.P.C. (or FERC) Project No. 2114), as more fully described in Section 2.2 of Resolution No. 474 adopted by the Commission on June 30, 1959, or as the same may be modified in accordance with Section 2.3 of Resolution No. 474, but shall not include any generation, transmission and distribution facilities hereafter constructed or acquired by the District as a part of the Electric System, or any other utility properties of the District acquired as a separate utility system, the revenues of which may be pledged to the payment of bonds issued to purchase, construct or otherwise acquire such separate utility system.

Revenue Fund

The District will pay into the Revenue Fund all Gross Revenue of the Electric System, exclusive of earnings on money on hand in any arbitrage rebate account, the R&C Fund, or the Reserve Fund or any other debt service reserve account securing Parity Bonds, which may be retained in such funds and account or transferred to other funds as required by the Bond Resolution.

Rate Stabilization Account

In accordance with the priorities set forth in “SECURITY FOR THE PARITY BONDS—Flow of Funds Under the Bond Resolution,” the District may from time to time deposit Net Revenues into the Rate Stabilization Account in the R&C Fund and may from time to time withdraw amounts therefrom to enhance rate stability or for other lawful purposes of the District related to the Electric System. Solely for purposes of calculating the coverage requirement, there shall be added to the Net Revenue in any year any amount withdrawn from the Rate Stabilization Account in such calendar year and deposited in the Revenue Fund, and there shall be subtracted from Net Revenue in any year any amount withdrawn from the Revenue Fund and deposited in the Rate Stabilization Account.

Bond Fund

The District obligates and binds itself irrevocably to set aside and pay into the Bond Fund out of the Gross Revenue of the Electric System certain fixed amounts in the following order of priority:

- (A) Bond Fund: On or before the day on which an installment of interest falls due an amount, together with funds available in such account, equal to the installment of interest next falling due on all outstanding Parity Bonds; in the case of Variable Rate Bonds transfers shall be made as specified in the resolution authorizing such bonds.

On or before the day on which an installment of principal falls due, the amount which, together with funds available in such account, shall equal the installment of principal next falling due on all outstanding Parity Bonds; and

On or before the due date of each Sinking Fund Requirement, an amount which, together with funds available in such account, will equal the Sinking Fund Requirement next falling due;

- (B) Reserve Fund: On or before the 25th day of each of the six months next succeeding each date of valuation of the amount in the Reserve Fund, 1/6th of the amount necessary to make the valuation of the amount in the Reserve Fund equal to 100% of the Reserve Fund Requirement, if the valuation of the amount in the Reserve Fund is less than 100% of the Reserve Fund Requirement. The valuation of the amount in the Reserve Fund must be made by the District on each December 31 and may be made on each June 30.

If the valuation of the amount in the Reserve Fund is greater than 100% of the Reserve Fund Requirement, then and only then may the District withdraw at any time prior to the next date of valuation from the Reserve Fund (i) the interest earned on the amounts credited to the Reserve Fund and (ii) the difference, if any, between the

amount of the valuation and the Reserve Fund Requirement. The District has reserved the right to substitute Qualified Insurance or a Qualified Letter of Credit (as defined in the Bond Resolution) to satisfy the Reserve Fund Requirement for any Parity Bonds, provided that the letter of credit or insurance is not cancelable on less than five years' notice.

Money in the Bond Fund may, at the option of the District, be invested or reinvested in Permitted Investments maturing, or which are callable at the option of the owner, prior to the maturity date of the final installment of principal of the Parity Bonds. For the purpose of determining the amount credited to the Reserve Fund, obligations in which money in the Reserve Fund have been invested are to be valued at the market value thereof plus accrued interest to the date of redemption for obligations maturing more than six months from the valuation date and at the par value thereof for obligations maturing within six months of the valuation date.

The District shall make up any deficiency in the Bond Fund from the funds available in the Reserve Fund. The District will replenish such withdrawals from the Reserve Fund from moneys in the Revenue Fund first available after making current specified payments into the Bond Fund, and after paying and making necessary provision for the payment of Operating Expenses.

The District will calculate the Reserve Fund Requirement as of the issuance of the Bonds, and will, on the date of delivery of the Bonds to the initial purchasers have on deposit in the Reserve Fund an amount equal to the Reserve Fund Requirement for the Bonds.

Additional Bonds

The District will not issue any bonds or other obligations subsequent to the issuance of the Bonds having a lien or charge on the Gross Revenue of the System prior to the lien and charge of the Bonds. Future Parity Bonds may be issued provided that the District shall comply with the following conditions:

1. At the time of issuance of such Future Parity Bonds there is no deficiency in the Bond Fund or in any of the accounts therein and no Event of Default has occurred or is continuing.
2. The Net Revenue of the Electric System for any 12 consecutive months out of the 24 months next preceding the issuance of such Future Parity Bonds, not including any transfer from the R&C Fund, will equal at least 1.25 times the Annual Debt Service required to be paid in any Fiscal Year thereafter. In calculating Annual Debt Service for purposes of this paragraph, if the interest rate on any Parity Bonds is other than a fixed rate, the rate used shall be any rate published as the Bond Buyer Revenue Bond Index for municipal revenue bonds within the 30-day period prior to the date of calculation. If on the date of such calculation the interest rate on any Variable Rate Bonds shall then be fixed for a specified period, including pursuant to a Derivative Product, the interest rate used for such specified period for the purpose of the foregoing calculation shall be such actual interest rate.

“Net Revenue of the Electric System” may be adjusted to include: (i) a full 12 months of Net Revenue from any customers added during the 12-month period being considered; (ii) the annual estimated Net Revenue to be received as a result of any additions, betterments and improvements to and extensions of the Electric System to be acquired, constructed or installed by the District from the proceeds of the Future Parity Bonds to be issued; and (iii) the additional Net Revenue which would have been received by the District if any rate change adopted prior to the delivery of the Future Parity Bonds, but subsequent to the beginning of the 12-month period being considered, had been in force during the full 12-month period.

3. At or prior to the issuance of such Future Parity Bonds, the District shall obtain and have on file a certificate from the Treasurer which shall certify full compliance with the conditions set forth above, or in the alternative, the District may obtain a certificate from a Professional Utility Consultant stating that the projected average annual Net Revenue for the Fiscal Years in which the

Parity Bonds, including the Future Parity Bonds being issued, are expected to at least equal 1.25 times the Annual Debt Service required to be paid in any Fiscal Year thereafter.

In the event that any Future Parity Bonds are issued for the sole purpose of exchanging with or providing funds to purchase or refund or redeem and retire at or prior to their maturity any or all outstanding Parity Bonds and the issuance of such refunding Future Parity Bonds and retirement of outstanding bonds and such refunding Future Parity Bonds will not require a greater amount (except as necessary to round out maturities to the nearest \$5,000) to be paid in any Fiscal Year thereafter than would have been required to be paid in the same Fiscal Year for debt service on the bonds being refunded, then paragraphs 2 and 3 above need not be complied with to permit such refunding Future Parity Bonds to be issued.

In the event that the District elects to meet the requirements with respect to the Reserve Fund as to any issue of Bonds through the use of a Qualified Letter of Credit, Qualified Insurance or other credit enhancement device, the District may contract with the person providing such Qualified Letter of Credit, Qualified Insurance or other credit enhancement device that the District's reimbursement obligation, if any, to such entity ranks on a parity of lien with payments into the Reserve Fund to secure the Bonds.

In the event that the District elects additionally to secure any issue of Variable Rate Bonds through the use of a letter of credit, insurance or other credit enhancement device, the District may contract with the entity providing such letter of credit, insurance or other credit enhancement device that the District's reimbursement obligation, if any, to such entity ranks on a parity of lien with the Bonds; provided that the payments due under such reimbursement obligation are such that if such reimbursement obligation were a series of Future Parity Bonds and assuming that such credit enhancement device were to be drawn upon for the full amount available, such Future Parity Bonds could be issued in compliance with the provisions regarding additional Bonds, excluding Annual Debt Service on the Variable Rate Bonds.

Separate System Bonds; Resource Obligations

The District may enter into contracts to purchase energy, capacity, capability, reserves, conservation or services or authorize and issue bonds, notes, certificates or other obligations or evidences of indebtedness, other than Bonds, to acquire or construct facilities or resources for the generation of power and energy, or for the conservation, transformation or transmission of power and energy, and any incidental properties to be constructed or acquired in connection therewith, which facilities or resources shall be a separate system and which contractual obligations, bonds or other obligations or evidences of indebtedness must be payable solely from the revenues or other income derived from the ownership or operation of such separate system. Costs associated with any such separate system may be declared by resolution of the Commission to be a Resource Obligation of the Electric System provided that the following requirements must be met at the time of such declaration:

- (1) No Event of Default with respect to any Parity Bonds or Resource Obligations has occurred and is continuing.
- (2) There must have been filed with the Secretary of the Commission a certificate of the Professional Utility Consultant stating that the additional source of power and energy or conservation from such Resource Obligation is consistent with sound utility power supply planning.
- (3) There must have been filed with the Secretary of the Commission a report of the Professional Utility Consultant stating that estimated annual Net Revenues for the second full Fiscal Year after the date of initial operation of the facilities, costs of which are to be financed as a Resource Obligation, or after the date of first delivery of energy, capacity, reserves or services pursuant to a contract, costs of which are declared to be a Resource Obligation, as the case may be, shall be at least equal to 125% of maximum Annual Debt Service in any future Fiscal Year. In estimating Net Revenues, the Professional Utility Consultant shall base such estimate on factors the Professional Utility Consultant deems to be reasonable and shall treat the costs of the Resource Obligation as Operating Expenses.

(4) In the event that the Resource Obligation is a contract to purchase energy, capacity, reserves or services, there must have been filed with the Secretary of the Commission opinions of counsel to all other parties to the contract, which opinions state that each party to the contract has all requisite right, power and authority to execute and deliver the contract and to perform its obligations thereunder and that the contract constitutes a legally valid and binding obligation of each party thereto.

(5) The Resource Obligation shall not be subject to acceleration if an event of default has occurred.

Derivative Products

To the extent permitted by state law the District may enter into Derivative Products on a parity with the Bonds or any Parity Bonds subject to the conditions set forth in the Bond Resolution and summarized below.

The following shall be conditions precedent to the use of any Derivative Product on a parity with any Bonds under the Bond Resolution:

(1) General Parity Tests. The Derivative Product and the obligations to which it relates must satisfy the requirements for Future Parity Bonds described in the Bond Resolution taking into consideration District Payments and Reciprocal Payments under the Derivative Product. Termination payments owed pursuant to a Derivative Product shall not be on a parity with the Parity Bonds.

(2) Opinion of Bond Counsel. The District shall obtain an opinion of bond counsel on the due authorization and execution of such Derivative Product, the validity and enforceability thereof and opining that the action proposed to be taken is authorized or permitted by the Bond Resolution and will not adversely affect the excludability for federal income tax purposes of the interest on any outstanding Parity Bonds.

(3) Payments. Each Derivative Product shall set forth the manner in which the District Payments and Reciprocal Payments are to be calculated and a schedule of Derivative Payment Dates.

(4) Supplemental Resolutions to Govern Derivative Products. Prior to entering into a Derivative Product, the District shall adopt a resolution, which shall:

(a) establish general provisions for the rights of providers of Derivative Products or Derivative Facilities; and

(b) set forth such other matters as the District deems necessary or desirable in connection with the management of Derivative Products as are not clearly inconsistent with the provisions of the Bond Resolution.

Defeasance

The District may set aside with a trustee or escrow agent in a special trust account irrevocably pledged to the payment of certain Bonds, cash and/or Government Obligations and/or Refunded Municipals in an amount, together with the earnings thereon, to provide funds to pay when due the interest on part or all of the Bonds and to redeem and retire such Bonds at or prior to maturity in accordance with their terms. In such event no further payments need to be made into the Bond Fund and such Bonds shall cease to be entitled to any lien, benefit or security of the Bond Resolution except the right to receive payment from such special account, and such Bonds shall not be deemed to be outstanding for any purpose of the Bond Resolution. Within 30 days following the defeasance of any of the Bonds, written notice will be mailed to S&P and Moody's at their main offices, and to all registered owners of Bonds at their addresses appearing in the bond register.

Rate Covenant

The District has covenanted to establish, maintain and collect rates or charges for electric energy and all other services, commodities and facilities sold, furnished or supplied by the District in connection with the ownership or operation of the Electric System that shall be fair and nondiscriminatory and adequate to provide (1) Gross Revenue, together with other available money, including without limitation transfers from the R&C Fund, sufficient for the payment of the principal of and interest on all outstanding Parity Bonds and all payments which the District is obligated to set aside in the Bond Fund, and for the proper operation and maintenance of the Electric System, and all necessary repairs, replacements and renewals thereof, the working capital necessary for the operation thereof, and for the payment of any and all amounts that the District may now or hereafter become obligated to pay from said Gross Revenue; and (2) Net Revenue in any Fiscal Year hereafter equal to at least 1.25 times the Annual Debt Service in such Fiscal Year on all outstanding Parity Bonds, excluding any capitalized interest thereon, in such Fiscal Year. Failure to comply with this covenant shall not constitute an Event of Default if the District, before the 90th day of the following Fiscal Year, employs a Professional Utility Consultant (acceptable to the Insurer) to recommend changes in the District's rates and imposes rates at least as high as those recommended by such consultant. For purposes of calculating the coverage requirement, there shall be added to the Net Revenue in any year any amount withdrawn from the R&C Fund in such calendar year and deposited in the Revenue Fund, and there shall be subtracted from Net Revenue in any year any amount withdrawn from the Revenue Fund and deposited in the R&C Fund. See "Rate Stabilization Account" above.

Additional Covenants

Efficient Operation of the System. The District will maintain the Electric System and all additions, betterments and extensions thereto in good repair, working order and condition, and will make all necessary and proper repairs, renewals, replacements, extensions and betterments thereto so that at all times the business carried on in connection therewith shall be properly and advantageously conducted, and the District will operate such properties and the business in connection therewith in an efficient manner and at reasonable cost.

Sale/Lease of Property. The District will not sell, mortgage, lease or otherwise dispose of or encumber all or any portion of the Electric System except that:

(1) The District may sell, lease or otherwise dispose of all or substantially all of the Electric System, provided that simultaneously with such sale, lease or other disposition, the District shall cause all of the Bonds to be, or deemed to be, no longer outstanding.

(2) Except as provided below, the District will not dispose of any part of the Electric System in excess of 5% of the value of the net utility plant of the District in service unless prior to such disposition:

(a) there has been filed with the Secretary of the Commission a certificate of a Professional Utility Consultant stating that such disposition will not impair the ability of the District to comply with the rate covenants set forth in the Bond Resolution; or

(b) provision is made for the payment, redemption or other retirement of a principal amount of Bonds and Future Parity Bonds equal to the greater of the following amounts:

(i) An amount which will be in the same proportion to the net principal amount of Bonds and Future Parity Bonds then Outstanding (defined as the total principal amount of Bonds then Outstanding less the amount of cash and investments in the Bond Fund) that the Gross Revenues attributable to the part of the Electric System sold or disposed of for the 12 preceding months bears to the total Gross Revenues for such period; or

(ii) An amount which will be in the same proportion of the net principal amount of Bonds then outstanding that the book value of the part of the Electric System sold or disposed of bears to the book value of the entire Electric System immediately prior to such sale or disposition.

The District may dispose of any portion of the Electric System that has become unserviceable, inadequate, obsolete, or unfit to be used or no longer necessary for the use in the operation of the Electric System.

Insurance. The District will keep the Electric System insured, and will carry such other insurance with responsible insurers against risks, accidents or casualties, at least to the extent that insurance is usually carried by municipal corporations operating like properties; provided, however, the District may institute or continue a self-insurance program with respect to any and all of the aforementioned risks.

Accounts, Records and Audits. The District shall keep proper books of account in accordance with generally accepted accounting principles as applied to governmental entities and with the rules of the Division of Municipal Corporations of the State Auditor's office of the State of Washington, or successors, or if no such rules are prescribed, then in substantial accordance with the uniform system of accounts prescribed by the Federal Energy Regulatory Commission or other federal agency having jurisdiction over electric public utility companies comparable to the District. The District shall cause its books to be audited annually by the State Auditor's office or, if such an audit shall not be made for 12 months after the close of any Fiscal Year of the District, by independent certified public accountants. Any Bondowner may obtain at the office of the District copies of the balance sheet and income and retained earnings statement of the Electric System as of the close of each Fiscal Year, and the income and expenses of such year, including the amounts paid into the Revenue Fund, the Bond Fund, and in any and all special funds created pursuant to the provisions of the Bond Resolution, and the amounts expended for maintenance, renewals, replacements, and gross capital additions to the Electric System.

Prohibition of Free Service. Except as required by law or in an amount not to exceed 1/10th of 1% of Annual Operating Expenses, the District will not furnish electric energy without charge. The District will promptly enforce the payment of delinquent accounts by discontinuing service to the extent then permitted by law, or by legal proceedings, or both; provided, that, to the extent permitted by law, the District may lend money and may provide commodities, services or facilities free of charge or at a reduced charge in connection with a plan of conservation of electric energy adopted by the Commission.

Other Covenants. The District shall not dissolve or terminate its existence, or consolidate with another entity, without paying or providing for the payment of all outstanding Parity Bonds. The District will use its best efforts to retain the FERC License for the Priest Rapids Project.

Continuing Disclosure Obligations. The District has agreed to provide ongoing disclosure in accordance with Section (b)(5) of SEC Rule 15c2-12. See "CONTINUING DISCLOSURE" for a discussion of this undertaking.

Amendments

Any amendments to the Bond Resolution may be made by the District with the consent of the owners of 66-2/3% in principal amount of the Parity Bonds then outstanding, provided that no such amendment shall extend the date of payment of principal of or any installment of interest on any Parity Bond or reduce the principal or redemption price thereof or the rate of interest thereon or advance the permissible redemption prior to maturity date of any Parity Bond or give any Parity Bond preference over any other Parity Bond, or reduce the percentage of Parity Bonds the owners of which are required to consent to an amendment of the Bond Resolution, or authorize the creation of any pledge prior to or on a parity with the Parity Bonds (except the issuance of Future Parity Bonds) without the consent of the owners of each such Parity Bond affected.

Without the consent of the owners of any Parity Bonds or Parity Lien Obligations, the District may adopt supplemental resolutions to add to the covenants of the District contained in, or to surrender any rights reserved to or conferred upon it by, the Bond Resolution, or to cure any ambiguity or correct any defect in the Bond Resolution which shall not adversely affect the interest of such owners in any material respect.

Events of Default; Remedies

Events of Default. Under the Bond Resolution the happening of the following shall constitute “Events of Default”:

1. Default in the punctual payment of the principal of and premium, if any, on any of the Parity Bonds.
2. Default in the punctual payment of interest on any Parity Bond.
3. Failure to provide for required Sinking Fund Requirement when the same become due.
4. Default in the observance of any other of the covenants and conditions in the Bond Resolution and such default continues for 90 days after the District receives from the Bondowners Trustee or from the owners of not less than 20% in principal amount of any Parity Bonds outstanding a written notice specifying and demanding the cure of such default.
5. If the District shall (except as permitted in the Bond Resolution) sell, transfer, assign or convey any properties constituting the Electric System or interests therein, or make any agreement for such sale or transfer).
6. If an order, judgment or decree is entered appointing a receiver, trustee or liquidator for the District or all or any substantial part of the Electric System; approving a petition filed against the District seeking the bankruptcy, arrangement or reorganization of the District, or assuming custody or control of the District or all or any substantial part of the Electric System and such order, judgment or decree shall not be vacated, set aside, stayed or terminated within 60 days from the date of the entry.
7. If the District admits in writing its inability to pay its debts generally as they become due, files a petition in bankruptcy, makes an assignment for the benefit of its creditors, consents to the appointment of a receiver of all or any substantial part of the Electric System, or consents to the assumption by any court of custody or control of the District or of the whole or any substantial part of the Electric System.

Remedies/Bondowners’ Trustee. So long as an Event of Default has not been remedied, a bondowners’ trustee (the “Bondowners’ Trustee”) may be appointed by the owners of 25% in principal amount of Parity Bonds outstanding. The Bondowners’ Trustee may be removed at any time, and a successor Bondowners’ Trustee may be appointed, by the registered owners of a majority in principal amount of Parity Bonds outstanding. The Bondowners’ Trustee may require such security and indemnity as may be reasonable against the costs, expenses and liabilities that may be incurred in the performance of its duties. The Bondowners’ Trustee may resign upon 60 days’ notice and a new Bondowners’ Trustee appointed by the owners of at least 25% in principal amount of Parity Bonds; provided, however, that no such resignation or removal shall be effective until a successor Bondowners’ Trustee shall have been appointed and shall have delivered a written instrument of acceptance of the duties and responsibilities of the Bondowners’ Trustee to the District and the owners of the outstanding Parity Bonds. In the event that any Event of Default in the sole judgment of the Bondowners’ Trustee is cured and the Bondowners’ Trustee furnishes to the District a certificate so stating, that Event of Default shall be conclusively deemed to be cured.

Upon the happening of an Event of Default and during the continuance thereof, the Bondowners’ Trustee may, and upon the written request of the registered owners of not less than 25% in principal amount of Parity Bonds outstanding shall, take such steps and institute such suits or other proceedings, all as it may deem appropriate for the protection and enforcement of the rights of the registered owners of the Parity Bonds, to collect any amounts due and owing to or from the District, or to obtain other appropriate relief, and may enforce the specific performance of any covenant, agreement or condition contained in the Bond Resolution or in any of the Parity Bonds.

Any such suit or proceeding instituted by the Bondowners' Trustee shall be brought for the ratable benefit of all of the registered owners of the Parity Bonds, subject to the provisions of the Bond Resolution. The respective owners of Parity Bonds outstanding, by taking and holding the same, shall be conclusively deemed irrevocably to appoint the Bondowners' Trustee the true and lawful trustee of the respective owners of those Parity Bonds, with authority to institute any such suit or proceeding; to receive as trustee and deposit in trust any sums becoming distributable on account of those Parity Bonds; to execute any paper or documents for the receipt of money; and to do all acts with respect thereto that the registered owner himself or herself might have done in person. Nothing herein shall be deemed to authorize or empower the Bondowners' Trustee to consent to accept or adopt, on behalf of any registered owner of Parity Bonds outstanding, any plan of reorganization or adjustment affecting those Parity Bonds or any right of any registered owner thereof, or to authorize or empower the Bondowners' Trustee to vote the claims of the owners thereof in any receivership, insolvency, liquidation, bankruptcy, reorganization or other proceeding to which the District is a party.

Any money collected by the Bondowners' Trustee at any time pursuant to the Bond Resolution shall be applied in the following order of priority: (i) first, to the payment of the charges, expenses, advances and compensation of the Bondowners' Trustee and the charges, expenses, counsel fees, disbursements and compensation of its agents and attorneys; and (ii) second, to the payment to the persons entitled thereto, first of required interest and then, of unpaid principal amounts on any Parity Bonds which shall have become due, whether at maturity or by proceedings for redemption or otherwise, in the order of their due dates and, if the amount available shall not be sufficient to pay in full the principal amounts due on the same date, then to the payment thereof ratably, according to the principal amounts due thereon to the persons entitled thereto, without any discrimination or preference.

Neither the registered owner nor the beneficial owner of any one or more of Parity Bonds shall have any right to institute any action, suit or proceeding at law or in equity for the enforcement of same unless: (i) an Event of Default has happened and is continuing; (ii) a Bondowners' Trustee has been appointed; (iii) such owner previously shall have given to the Bondowners' Trustee written notice of the Event of Default on account of which such suit, action or proceeding is to be instituted; (iv) the owners of 25% in principal amount of the Parity Bonds outstanding, after the occurrence of such Event of Default, has made written request of the Bondowners' Trustee and have afforded the Bondowners' Trustee a reasonable opportunity to institute such suit, action or proceeding; (v) there have been offered to the Bondowners' Trustee security and indemnity satisfactory to it against the costs, expenses and liabilities to be incurred therein or thereby; and (vi) the Bondowners' Trustee has refused or neglected to comply with such request within a reasonable time.

Limitations of Remedies

In addition to the limitations on remedies contained in the Bond Resolution, the rights and obligations under the Bonds and the Bond Resolution may be subject to bankruptcy, insolvency, reorganization, arrangement, fraudulent conveyance, moratorium and other laws relating to or affecting creditors' rights, to the application of equitable principles, to the exercise of judicial discretion in appropriate cases, and to limitations on legal remedies against public utility districts in the State. The opinion to be delivered by Foster Pepper PLLC, as Bond Counsel, concurrently with the issuance of the Bonds, to the effect that the Bonds constitute legal, valid and binding obligations of the District and that the Bond Resolution constitutes a valid and binding obligation of the District, will be subject to such limitations, and the various other legal opinions to be delivered concurrently with the issuance of the Bonds will be similarly qualified. In the event the District fails to comply with its covenants under the Bond Resolution or to pay principal of or interest on the Bonds, there can be no assurance that available remedies will be adequate to fully protect the interests of the Owners of the Bonds.

APPENDIX B

**AUDITED FINANCIAL STATEMENTS OF THE DISTRICT
AS OF DECEMBER 31, 2012 AND 2011**

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Independent Auditor's Report

To the Board of Commissioners of
Public Utility District No. 2 of
Grant County, Washington

We have audited the accompanying financial statements of Public Utility District No. 2 of Grant County, Washington (the "District"), which comprise the statements of net position as of December 31, 2012 and December 31, 2011, and the related statements of revenues and expenses and changes in net position and of cash flows for the years then ended.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on the financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the District's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the District's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the District at December 31, 2012 and December 31, 2011, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.



Other Matters

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 2 through 9 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in the appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Our audits were conducted for the purpose of forming opinions on the basic financial statements. The Supplemental Disclosures of Telecommunication Activities in Note 11 are presented for purposes of additional analysis and are not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audits of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the financial statements taken as a whole.

PricewaterhouseCoopers LLP

April 19, 2013

PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

MANAGEMENT'S DISCUSSION AND ANALYSIS DECEMBER 31, 2012 AND 2011

As of December 31, 2012, Public Utility District No. 2 of Grant County, Washington (the "District") comprises two operating systems: the Electric System and the Priest Rapids Project which consists of the Priest Rapids Hydroelectric Production Development ("Priest Rapids") and the Wanapum Development ("Wanapum"). The Priest Rapids Project is operated under Federal Energy Regulatory Commission ("FERC") License, Project No. 2114.

Presented below is a discussion and analysis of the financial activities for the years ended December 31, 2012, 2011, and 2010. Please read it in conjunction with the financial statements, which follow this section.

OVERVIEW OF DISTRICT'S FINANCIAL STATEMENTS

This annual financial report consists of a series of financial statements and reflects the self-supporting, proprietary activities of the District funded primarily by the sale of electrical power. The District reports the business-type activities in a manner similar to private business enterprises. The District's financial statements presented in this report consist of the Statements of Net Position, Statements of Revenues and Expenses and Changes in Net Position, Statements of Cash Flows, and the Notes to the Financial Statements.

The Statements of Net Position include all of the District's assets, liabilities, and net position and provide information about the nature and amounts of investments in assets and the obligations of the District.

All of the revenues and expenses of the District are accounted for in the Statements of Revenues and Expenses and Changes in Net Position. These statements measure the success of the District's operations over the year and can be used to determine whether the District has successfully recovered all of its costs through rates and other charges.

The primary purpose of the Statements of Cash Flows is to provide information about the District's cash receipts and cash disbursements during the year. These statements report cash receipts, cash payments and net changes in cash resulting from operating, financing, and investing activities.

The Notes to the Financial Statements provide additional information that is essential for a full understanding of the information provided in the three statements described above.

FINANCIAL HIGHLIGHTS

In May of 2012, the District issued \$127.6 million of revenue and refunding bonds, at a net premium of \$11.7 million, associated with the Priest Rapids Project to finance improvements at the Priest Rapids Project, to refund certain bonds previously issued, to pay issuance costs, and to fund a debt service reserve. In September of 2011, the District defeased \$53 million of the Electric System 2001-H bonds. In October of 2011, the District also issued \$156.1 million of revenue and refunding bonds, at a net premium of \$20.8 million, associated with the Electric System to finance improvements in the Electric System, to refund certain bonds previously issued, to pay issuance costs, and to fund a debt service reserve. In April of 2010, the District issued \$349.4 million of

PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

MANAGEMENT'S DISCUSSION AND ANALYSIS DECEMBER 31, 2012 AND 2011

bonds associated with the Priest Rapids Project to finance improvements at the Priest Rapids Project, to refund certain bonds previously issued, to pay issuance costs, and to fund a debt reserve. The District had revenue bonds outstanding of \$1.08 billion as of December 31, 2012, and \$1.07 billion as of December 31, 2011 and 2010. See Note 5.

The Commission implemented rate increases to retail customers in April of 2010, February of 2011, January of 2012, and January of 2013 in the amounts of 4%, 6%, 8%, and 6%, respectively. The Commission-adopted budget and forecast has future overall rate increases of 8% for the years 2014 and 2015 and 4% for 2016. The largest driver of these rate increases is the rising cost to produce power at the Priest Rapids Project. Cost increases are related to the replacement of turbines and generators at the two dams as well as obligations to build parks, construct and operate fish hatcheries and protect cultural resources as required in the District's federal license.

The Priest Rapids Power Sales Contracts with 17 regional utilities extend to 2052. Each power purchaser is obligated to make payments equal to annual power costs, which include all operating expenses and debt service on the Parity Bonds and debt service coverage less any interest earnings multiplied by the percentage of output or revenue, as applicable, that the purchaser is entitled to that year. In accordance with the FERC Order in the Public Law 83-544 proceeding, the District dedicates 30% of the combined output of the Priest Rapids Project for sales based on market principles. The power purchasers are entitled to receive the net revenues from the sale of the 30% portion to the extent the District does not need the revenues to purchase power to meet the Electric System's firm loads. Since November 1, 2005, the District has been able to meet all of its forecasted firm load requirements with Priest Rapids and Wanapum generation and other benefits derived from the Priest Rapids Project.

The District is a statutory preference customer of the Bonneville Power Administration ("BPA") and, as such has priority for power requirements over BPA's nonpreference customers. In 2012, 2011, and 2010 the District purchased 1%, 32%, and 42%, respectively, of its power from BPA. The Electric System's ability to meet more of its load requirements with power from the Priest Rapids Project has significantly reduced its reliance on power from BPA. The District's previous contract with BPA expired September 30, 2011. The District executed a new contract with BPA, effective October 1, 2011, to serve only the District's loads in the Grand Coulee area, which is a small area not easily served by the Priest Rapids Project. The new contract with BPA represents roughly 1% of the District's load in the foreseeable future.

This significant reduction in power supplied by BPA to serve load does not affect the District financially. Since November of 2005, under provisions in the Priest Rapids Power Sales Contracts, the District has been providing Priest Rapids Project generation to some of its power purchasers at a similar price and quantity as what it received from BPA. This portion of the Power Sales Contracts expired on the same date the BPA contract expired, September 30, 2011. These agreements have offset one another in both load resource and finances since 2005. The termination of these contracts has no net impact on the District. See Note 6.

PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

MANAGEMENT'S DISCUSSION AND ANALYSIS DECEMBER 31, 2012 AND 2011

In 2008, the District determined the final scope and design of a long-term capital improvement project for the Wanapum facilities. A contract was awarded January 5, 2009, to Alstom Hydro US, Inc. for approximately \$150 million to upgrade all ten generators at Wanapum Dam. The on-site construction began in June of 2010 and is scheduled through June of 2018. The existing generators are currently rated at 109.26 megavolt-amperes ("MVA"). The new upgraded generators have a nameplate rating of 128.6 MVA, an increase of 17.7%.

The District is nearing the end of a long-term turbine upgrade project at Wanapum Dam. In December of 2012, the ninth turbine and third generator were commissioned and began generating power. In February of 2012, the eighth turbine and second generator were completed. In April of 2011, the seventh turbine and the first generator were completed. The District anticipates completion of the tenth and final turbine and fourth generator by November of 2013. As of December 31, 2012, the cost of the remaining Wanapum turbines and generators to be replaced is estimated at \$11.6 million and \$106.6 million, respectively.

The District entered into a contract to sell a portion of the Electric System's share from the Priest Rapids Project to Iberdrola Renewables, Inc. Effective December 1, 2011, and terminating November 30, 2014, this 12% share of the Priest Rapids Project output increases District net revenue stability by improving the predictability of wholesale revenues. The \$104.4 million contract is paid in 36 equal monthly installments over the life of the agreement. The District regularly monitors its exposure with Iberdrola and retains the right to call for additional assurances at any time. The District has the right to curtail delivery in the event of non-payment.

The District began construction work in late 2012 to build a 35.3 mile 230 kV transmission line that spans from the Rocky Ford Substation to the Columbia substation. This project is scheduled to be in construction through March 2014 and be fully in service by mid-2014. The estimated cost is \$45.1 million. The benefits include significant reduction of transmission costs, an improved ability to deliver power from the District's hydroelectric projects to customers, improved transmission system reliability, and allowing the District to better serve load growth in the central county area.

PRIEST RAPIDS PROJECT

The Priest Rapids Project consists of the Priest Rapids dam and the Wanapum dam.

Priest Rapids consists of a dam and hydroelectric generating station having a nameplate rating of 955,600 kilowatts ("kW"). Priest Rapids is located on the Columbia River in Grant and Yakima Counties about 150 air miles northeast of the City of Portland, 130 air miles southeast of the City of Seattle and 18 miles downstream of Wanapum.

Wanapum consists of a dam and hydroelectric generating station having a nameplate rating of 1,092,600 kW. Wanapum is located on the Columbia River in Grant and Kittitas Counties about 160 air miles northeast of the City of Portland, 129 air miles southeast of the City of Seattle and 18 miles upstream of Priest Rapids.

PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

MANAGEMENT'S DISCUSSION AND ANALYSIS DECEMBER 31, 2012 AND 2011

During the year ended December 31, 2012, the Priest Rapids Project provided 8,747,538 megawatt hours ("MWh") of electric energy at an average cost of \$15.47 per MWh. During the year ended December 31, 2011, the Priest Rapids Project provided 9,573,895 MWh of electric energy at an average cost of \$14.64 per MWh. During the year ended December 31, 2010, the Priest Rapids Project provided 7,060,574 MWh of electric energy at an average cost of \$18.97 per MWh.

While operating costs have remained generally consistent, the change in average costs per MWh at the Priest Rapids Project from 2010 to 2012 was driven primarily by runoff water available for generation. Runoff was 120%, 126%, and 80% of average for 2012, 2011, and 2010, respectively. The timing of the runoff and spill requirements factor into the water available for generation from year to year.

PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

MANAGEMENT'S DISCUSSION AND ANALYSIS DECEMBER 31, 2012 AND 2011

CONDENSED COMPARATIVE FINANCIAL INFORMATION

(AMOUNTS IN THOUSANDS)

Statements of Net Position	2012	2011	2010
Assets			
Current	\$ 228,112	\$ 220,465	\$ 230,558
Net utility plant	1,515,539	1,408,063	1,330,747
Noncurrent	<u>306,926</u>	<u>351,944</u>	<u>342,023</u>
Total assets	<u>\$ 2,050,577</u>	<u>\$ 1,980,472</u>	<u>\$ 1,903,328</u>
Liabilities			
Current	\$ 142,025	\$ 128,352	\$ 134,241
Noncurrent	<u>1,116,159</u>	<u>1,112,883</u>	<u>1,087,524</u>
Total liabilities	<u>1,258,184</u>	<u>1,241,235</u>	<u>1,221,765</u>
Net position			
Invested in capital assets, net of related debt	531,794	531,496	463,303
Restricted	95,051	74,869	60,672
Unrestricted	<u>165,548</u>	<u>132,872</u>	<u>157,588</u>
Total net position	<u>792,393</u>	<u>739,237</u>	<u>681,563</u>
Total liabilities and net position	<u>\$ 2,050,577</u>	<u>\$ 1,980,472</u>	<u>\$ 1,903,328</u>
Revenues and Expenses and Changes in Net Position			
Operating revenues	\$ 263,252	\$ 293,065	\$ 267,897
Operating expenses	<u>176,267</u>	<u>204,608</u>	<u>216,241</u>
Net operating income	<u>86,985</u>	<u>88,457</u>	<u>51,656</u>
Other revenues (expenses)	(37,677)	(39,443)	(39,060)
Contributions in aid of construction	<u>3,848</u>	<u>8,660</u>	<u>8,872</u>
Change in net position	<u>\$ 53,156</u>	<u>\$ 57,674</u>	<u>\$ 21,468</u>

PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

MANAGEMENT'S DISCUSSION AND ANALYSIS DECEMBER 31, 2012 AND 2011

FINANCIAL ANALYSIS

The following discussion provides comparative financial information for the years ended December 31, 2012, 2011, and 2010.

ASSETS

Current assets from 2010 to 2012 have only fluctuated 1%. Inventories and receivables have remained consistent.

Noncurrent assets have decreased 10% between 2010 and 2012. The ebbs and flows of the non-current assets balance is driven primarily by unspent bond proceeds. Since these proceeds are reserved for construction of plant assets, the timing of bond issues and the subsequent transition to net plant affects the balance from year to year.

Net plant increased 5.8% from 2010 to 2011 and 7.6% from 2011 to 2012. These increases reflect the substantial investment in plant in the Electric System, the continued investments in the turbines and generators at Wanapum, and other capital improvements in both systems.

LIABILITIES

The District had approximately \$1.1 billion in bonded debt as of years ended December 31, 2012, 2011, and 2010, all of which is at fixed rates. In May of 2012, the District issued bonds to finance capital improvements for the Priest Rapids Project. The total par value of the bond offering was \$127.6 million, of which \$94.1 million was used to refund prior bond issues. The 2012 bonds were issued at fixed interest rates at a net original issue premium of \$11.7 million. The 2012 Priest Rapids Project issue was an opportunity for the District to issue the \$42.4 million remaining of its Clean Renewable Energy Bond allocation. The bonds have a 70% refund from the Federal Government on interest payments made. In October of 2011, the District issued \$156.1 million in Electric System revenue and refunding bonds. The 2011 bonds were issued at an All-In True Interest Cost of 2.55%. The District used a portion of the bond proceeds to retire \$62.8 million of 2001-H revenue and refunding bonds. The Electric System also used cash reserves in 2011 to defease \$53 million of the 2001-H bond issue. During April of 2010, the District issued bonds to finance capital improvements for the Priest Rapids Project. The total par value of the bond offering was \$349.4 million, of which \$34.5 million was used to refund prior bond issues. The 2010 bonds were issued at fixed interest rates with the District accessing available Build America Bonds and Clean Renewable Energy Bonds which offers, respectively, a 35% and 70% refund from the Federal Government on interest payments made.

In March of 2010, Standard & Poor's and Fitch Ratings reaffirmed the 'AA-/stable outlook' and 'AA/stable outlook', respectively, for the Electric System, Priest Rapids, Wanapum and the Priest Rapids Project System's bonds. Moody's, on the other hand, downgraded the District's bonds from 'Aa2' to 'Aa3/stable outlook'. In September of 2011, all three rating agencies affirmed their March of 2010 ratings and outlooks for the Priest Rapids, Wanapum, and the Priest Rapids Project System bonds and assigned an identical rating and outlook to the 2011-I bond issue for the Electric System.

PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

MANAGEMENT'S DISCUSSION AND ANALYSIS DECEMBER 31, 2012 AND 2011

In May of 2012, all three rating agencies affirmed the 2011 ratings and outlooks and assigned an identical rating and outlook to the 2012 bond issue for the 2012 Priest Rapids Project bonds. The strengths listed by all rating agencies included low-cost hydroelectric resources from the Priest Rapids Project and the willingness and ability of the District to raise retail rates as needed in the Electric System.

NET POSITION

Net position increased by over \$53.2 million and \$57.7 million in 2012 and 2011, respectively. This is reflective of ample generation and surplus power sales due to exceptional river flows of 120% and 126% of average for 2012 and 2011, respectively. Net position increased approximately \$21 million in 2010. This is a modest increase when compared to 2012 and 2011 and is indicative of the lower river flows of 80% of average.

STATEMENT OF REVENUES AND EXPENSES

The Sales to power purchasers at cost is directly tied to power costs (operating expenses – noncash items + debt service – interest earnings). Additional expenses related to compliance with the license and other fish and operational costs have added to the revenues required to cover the cost of production.

The Retail energy sales and Sales to other utilities revenues, on the other hand, are reflective of the individual ebbs and flows of the economy through power consumption and market forces on wholesale power prices. 2011's \$25.2 million increase in operating revenues resulted from more surplus power available for Sales to other utilities coupled with retail rate increases and increased consumption, particularly in the commercial and industrial loads. In 2012, revenues decreased \$29.8 million due primarily to the expiration of the BPA block contract in 2011 previously described, which had the effect of reducing wholesale revenues, and power costs, by approximately \$30 million.

The expiration of the BPA block contract as of September 30, 2011, and increased generation from the Priest Rapids Project allowed the Electric System to purchase less power from other sources in 2011 to meet its loads. This resulted in a decrease of Purchased power expense by over \$12 million compared to 2010 and an even steeper decrease of \$29.5 million from 2011 to 2012.

Other revenues (expenses) remained flat from 2010 to 2012.

Contributions in aid of construction ("CIAC's") for 2010 and 2011 were nearly \$9 million with SGL Automotive and various data centers making up the majority of the contributions. CIAC's decreased to \$3.8 million for 2012. This amount is more reflective of normal expansion of the Electric System.

PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

MANAGEMENT'S DISCUSSION AND ANALYSIS

DECEMBER 31, 2012 AND 2011

CONTACTING THE DISTRICT'S FINANCIAL MANAGEMENT

This report is designed to provide the District's customers, bondholders, creditors and other interested parties with a general overview of the District's finances. If you have questions about this report or need additional information, contact the District's Chief Financial Officer at the Public Utility District No. 2 of Grant County, P.O. Box 878, Ephrata, Washington, 98823.

PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

STATEMENTS OF NET POSITION DECEMBER 31, 2012 AND 2011 (AMOUNTS IN THOUSANDS)

ASSETS	2012	2011
CURRENT ASSETS		
Cash	\$ 5,524	\$ 4,256
Investments	101,724	104,758
Restricted funds		
Cash	9,014	5,802
Investments	69,494	65,127
Customer accounts receivable, net of allowance for uncollectible accounts	21,144	19,105
Materials and supplies	19,216	19,819
Other current assets	1,996	1,598
Total current assets	228,112	220,465
NONCURRENT ASSETS		
Investments	35,885	14,575
Restricted funds		
Cash	10,645	7,566
Investments	246,785	314,108
Unamortized debt expense	7,713	8,337
Conservation loans	791	713
Demand-side management	3,604	4,481
Other noncurrent assets	1,503	2,164
Total other noncurrent assets	306,926	351,944
Utility plant, net of accumulated depreciation and amortization	1,515,539	1,408,063
Total noncurrent assets	1,822,465	1,760,007
TOTAL ASSETS	\$ 2,050,577	\$ 1,980,472

The accompanying notes are an integral part of these financial statements.

PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

STATEMENTS OF NET POSITION DECEMBER 31, 2012 AND 2011 (AMOUNTS IN THOUSANDS)

LIABILITIES AND NET POSITION	2012	2011
CURRENT LIABILITIES		
Accounts payable		
Trade	\$ 35,881	\$ 33,165
Wages payable	12,077	11,917
Power purchasers	3,377	3,370
Accrued taxes	5,351	4,919
Customer deposits	3,794	2,966
Accrued bond interest	27,457	25,351
Unearned revenue	107	1,176
Habitat liability	11,430	10,253
Other current liabilities	40	40
Current portion of licensing obligations	3,646	3,675
Current portion of long-term debt	38,865	31,520
	142,025	128,352
Total current liabilities		
NONCURRENT LIABILITIES		
Accrued other postemployment benefits	1,240	1,068
Long-term unearned revenue	1,393	1,500
Licensing obligations, less current portion	46,550	47,384
Revenue bonds, less current portion	1,041,810	1,041,610
Unamortized discounts and premiums, net	34,351	28,053
Unamortized refunding loss	(9,185)	(6,732)
	1,116,159	1,112,883
Total noncurrent liabilities		
Total liabilities	1,258,184	1,241,235
COMMITMENTS AND CONTINGENCIES (NOTES 6, 7, 8, 9, and 10)		
NET POSITION		
Invested in capital assets, net of related debt	531,794	531,496
Restricted	95,051	74,869
Unrestricted	165,548	132,872
	792,393	739,237
Total net position		
TOTAL LIABILITIES AND NET POSITION	\$ 2,050,577	\$ 1,980,472

The accompanying notes are an integral part of these financial statements.

PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

STATEMENTS OF REVENUES AND EXPENSES AND CHANGES IN NET POSITION FOR THE YEARS ENDED DECEMBER 31, 2012 AND 2011 (AMOUNTS IN THOUSANDS)

	2012	2011
OPERATING REVENUES		
Sales to power purchasers at cost	\$ 52,353	\$ 53,005
Retail energy sales		
Residential	35,898	34,342
Irrigation	19,501	17,271
Commercial and industrial	87,492	82,185
Governmental and others	1,019	1,006
Sales to other utilities	61,782	100,547
Wholesale fiber optic network sales	3,833	3,415
Other	1,374	1,294
	<u>263,252</u>	<u>293,065</u>
OPERATING EXPENSES		
Purchased power	17,395	46,927
Generation	23,923	22,810
Transmission	8,449	11,363
Distribution	13,420	12,381
Customer and information services	6,804	4,659
Wholesale fiber optic network operations	1,290	1,214
Administrative and general	26,584	25,728
License compliance and related agreements	18,276	22,069
Depreciation and amortization	47,857	45,239
Taxes	12,269	12,218
	<u>176,267</u>	<u>204,608</u>
NET OPERATING INCOME	<u>86,985</u>	<u>88,457</u>
OTHER REVENUES (EXPENSES)		
Interest and other income	3,477	4,009
Interest on revenue bonds and other, net of capitalized interest of \$2,178 and \$2,780	(51,364)	(50,773)
Federal rebates on revenue bonds	7,809	7,123
Amortization of debt expense, discount, and premium	2,401	198
	<u>(37,677)</u>	<u>(39,443)</u>
CONTRIBUTIONS IN AID OF CONSTRUCTION	<u>3,848</u>	<u>8,660</u>
CHANGE IN NET POSITION	<u>53,156</u>	<u>57,674</u>
NET POSITION		
Beginning of year	<u>739,237</u>	<u>681,563</u>
End of year	<u>\$ 792,393</u>	<u>\$ 739,237</u>

The accompanying notes are an integral part of these financial statements.

PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

STATEMENTS OF CASH FLOWS FOR THE YEARS ENDED DECEMBER 31, 2012 AND 2011 (AMOUNTS IN THOUSANDS)

	2012	2011
CASH FLOWS FROM OPERATING ACTIVITIES		
Cash received from retail energy sales	\$ 141,818	\$ 134,288
Cash received from sales to power purchasers at cost	52,360	55,544
Cash received from sales to other utilities	62,204	99,350
Other cash received	5,190	5,052
Cash received (paid) for customer deposits	844	(135)
Cash paid for purchase of power	(20,225)	(50,322)
Cash paid to contractors, suppliers, and employees	(96,897)	(92,309)
Taxes paid	(11,848)	(11,600)
	133,446	139,868
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Principal paid on revenue bonds	(31,520)	(36,043)
Interest paid on revenue bonds	(49,251)	(57,914)
Federal interest rebates	7,809	7,123
Bond proceeds	139,361	176,603
Payment on refunded debt	(92,448)	(64,477)
Payment on defeased debt	-	(54,409)
Bond issuance cost	(976)	(462)
Cash received from contributions in aid of construction	2,548	8,748
Licensing obligation payments	(3,407)	(5,592)
Acquisition and construction of plant assets	(146,327)	(115,015)
Proceeds on sale of plant assets	249	436
Miscellaneous nonoperating income	847	469
	(173,115)	(140,533)
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of investment securities	(453,286)	(529,134)
Sale proceeds of investment securities	498,067	533,761
Investment income proceeds	2,525	1,256
Net repurchase agreement	-	(7,500)
Cash paid for conservation loans	(78)	(163)
	47,228	(1,780)
NET INCREASE (DECREASE) IN CASH	\$ 7,559	\$ (2,445)

The accompanying notes are an integral part of these financial statements.

PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

STATEMENTS OF CASH FLOWS FOR THE YEARS ENDED DECEMBER 31, 2012 AND 2011 (AMOUNTS IN THOUSANDS)

	2012	2011
CASH AT END OF YEAR	\$ 25,183	\$ 17,624
CASH AT BEGINNING OF YEAR	<u>17,624</u>	<u>20,069</u>
NET INCREASE (DECREASE) IN CASH	<u>\$ 7,559</u>	<u>\$ (2,445)</u>
OPERATING ACTIVITIES		
Net operating income	\$ 86,985	\$ 88,457
Adjustments to reconcile net operating income to net cash provided by (used in) operating activities:		
Depreciation and amortization	47,857	45,239
Accretion expense	2,544	2,611
Earned revenue from deposits	(107)	(107)
Provision for uncollectible accounts	(4)	11
Changes in assets and liabilities		
Change in Habitat funds held in trust	1,458	2,130
Customer accounts receivable	(1,803)	(1,297)
Materials and supplies	603	672
Other current assets	(398)	2,739
Trade and wages payables	(5,117)	(3,773)
Payable to power purchasers, net	7	2,540
Accrued taxes	432	604
Customer deposits	816	(126)
Other current liabilities	-	19
Accrued other postemployment benefits	173	149
NET CASH PROVIDED BY OPERATING ACTIVITIES	<u>\$ 133,446</u>	<u>\$ 139,868</u>

The accompanying notes are an integral part of these financial statements.

PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

NOTES TO THE FINANCIAL STATEMENTS

DECEMBER 31, 2012 AND 2011

1. ORGANIZATION AND ACCOUNTING POLICIES

Public Utility District No. 2 of Grant County, Washington (the “District”) is composed of two operating systems: the Electric System and the Priest Rapids Project. The Priest Rapids Project is operated under Federal Energy Regulatory Commission (“FERC”) License, Project No. 2114. The District also maintains a Service System to provide administrative services to the operating systems. Internal transactions, including revenues and expenses between the District’s reporting segments and the Service System, have been eliminated in the accompanying financial statements in accordance with accounting principles generally accepted in the United States of America. The District is required by its financing arrangements to maintain separate accounts and to report separately on each operating system. See Note 12. The financing arrangements require maintenance of certain funds and application of accounting procedures prescribed by the State of Washington, which generally conform to those prescribed by FERC and accounting principles generally accepted in the United States of America. The accompanying financial statements are those of the District, which generates, transmits and distributes electric energy and wholesale fiber optic network services within Grant County, Washington.

The District maintains its accounts in accordance with accounting principles generally accepted in the United States of America for proprietary funds as prescribed by the Governmental Accounting Standards Board (“GASB”). The District’s accounting records generally follow the Uniform System of Accounts for public utilities and licensees prescribed by FERC except as it relates to the accounting for contributions in aid of construction (“CIAC”). FERC prescribes for CIAC proceeds to be recorded as a reduction to plant.

In December 2010, the GASB issued Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, effective for the District for the year ending December 31, 2012. The District implemented GASB No. 62 for the year ended December 31, 2012, and the implementation did not have a material impact on the District’s financial statements.

In June 2011, the GASB issued Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*, effective for the District the year ended December 31, 2012. This Statement modifies the presentation of deferred inflows and deferred outflows in the financial statements and changes the labeling of “net assets”, as previously presented, to “net position”. Implementation of Statement No. 63 had no effect on the District’s net position or changes in net position for the year ending December 31, 2012.

In March 2012, the GASB issued Statement No. 65, *Items Previously Reported as Assets and Liabilities*. This Statement establishes accounting and financial reporting standards that reclassify, as deferred outflows of resources or deferred inflows of resources, certain items that were previously reported as assets and liabilities and recognizes, as outflows of resources or inflows of resources, certain items that were previously reported as assets and liabilities.

PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

NOTES TO THE FINANCIAL STATEMENTS DECEMBER 31, 2012 AND 2011

The requirements of Statement No. 65 are effective for the District for the year ending December 31, 2013. Management is currently evaluating the impact this statement will have on the District's future financial statements.

In June 2012, GASB issued Statement No. 68, *Accounting and Financial Reporting for Pensions – An Amendment of GASB Statement No. 27*. The primary objective of Statement No. 68 is to improve accounting and financial reporting by state and local governments for pensions. This statement establishes standards for measuring and recognizing liabilities, deferred outflows and deferred inflows of resources and expenses. For defined benefit pension plans, this statement identifies the methods and assumptions that should be used to project benefit payments, discount projected benefit payments to their actuarial present value and attribute that present value to periods of employee service. This Statement will require the District to account for its proportional share of multi-employer plans, including the State pension fund. Note disclosure and required supplementary information about pensions are also addressed. Statement No. 68 is effective for the District beginning in fiscal year 2015. The District is currently evaluating the financial statement impact of adopting this statement.

Revenue Recognition – The District recognizes revenues associated with power sales to its retail and wholesale customers when delivered, which includes an estimate of revenue earned but not billed to customers as of year-end.

Revenues associated with power sales from the Priest Rapids Project under the Power Sales Contracts described in Note 6 are recorded on a cost-based formula specified in the contracts which include operation and maintenance costs, 115% of debt service and adjustments related to other factors. Depreciation, amortization, charges paid by the Renewal, Replacement and Contingency Fund, and Construction Funds are not considered costs of producing and delivering power for this purpose.

Allowance for Uncollectible Accounts – Management reviews accounts receivable on a regular basis to determine if any receivables will potentially be uncollectible. The allowance for uncollectible accounts includes amounts due from specific customers for which collection is in question. Such estimates are developed based on historical experience. For 2012 and 2011, the allowance for uncollectible accounts was \$324,000 and \$328,000, respectively.

Contributions in Aid of Construction – A portion of the District's utility plant is financed through contributions from customers in accordance with the District's line extension policy. Additionally, a portion of utility plant may be financed through contributions from other sources, such as other governmental organizations. The District recognizes capital contributions from these sources as non-operating revenue at the point at which it becomes nonrefundable. The District recognized \$3.8 million and \$8.7 million of contributions in aid of construction for the years ended December 31, 2012 and 2011, respectively.

Capitalized Interest – Interest costs incurred to finance major construction projects are capitalized as part of the cost of the project. The composite interest rate for calculating capitalized interest was 3.32% and 3.68% for 2012 and 2011, respectively.

PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

NOTES TO THE FINANCIAL STATEMENTS

DECEMBER 31, 2012 AND 2011

Utility Plant – Utility plant assets are recorded at cost including an allocation of internal payroll and other administrative and general costs associated with construction of the assets. Depreciation is determined by the straight-line method over the estimated life of the asset. The District's asset lives used for computing depreciation range from five to 100 years, with a composite rate of 2.34% and 2.33% for 2012 and 2011, respectively. When utility plant assets are retired, their original cost, together with removal costs, less salvage, are charged to accumulated depreciation. The District does not collect costs of disposal through rates. Such costs are charged to accumulated depreciation.

The costs of maintenance and repairs are charged to operations as incurred. Renewals, replacements, and betterments are capitalized. The District assesses its assets for obsolescence and possible impairment on a periodic basis. Once an asset has been identified as impaired and selected for liquidation, it is written down to its net realizable value, based on fair market value less settlement costs and the associated impairment loss is charged to operations.

Energy Conservation and Demand-Side Management (“DSM”) Programs – The District's expenditures for regional conservation programs and other DSM programs which benefit future periods by reducing energy supply requirements have historically been capitalized and amortized over the expected useful lives of the programs. During 2009, the District began expensing DSM costs as Customer information and services expense. The balances accumulated prior to the change in accounting are being amortized over the original useful lives of the programs.

Cash –The District classifies only amounts held in demand deposit accounts as cash.

Investments – Investments with maturities of more than twelve months are presented at fair value. Fair values are based on quoted market prices for those investments. All other investments are presented at amortized cost in accordance with GASB No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools* on the basis that their amortized cost approximates fair value for these instruments of shorter maturity. Discounts and premiums on investments are amortized as adjustments to interest income over the remaining term of the investments using the constant yield method.

Short-term investments are defined as investments with a maturity of less than one year. The purchase and maturity of investment instruments are reported on a gross basis in the Statements of Cash Flows, with the exception of repurchase agreements, which are reported on a net basis.

Changes in unrealized gains and losses on investments with maturities held for more than one year and realized gains and losses during the current year are included in Interest and other income on the Statements of Revenues and Expenses and Change in Net Position.

PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

NOTES TO THE FINANCIAL STATEMENTS DECEMBER 31, 2012 AND 2011

Materials and Supplies – Materials and supplies consist of hydroelectric generation, transmission, and distribution assets as well as fiber optic cable and fiber-related supplies. All inventory amounts are recorded at average cost.

Due from (to) Power Purchasers – This balance represents actual power costs in excess (deficit) of estimated power costs received by the Priest Rapids Project from power purchasers to be collected from, or due to, the power purchasers.

Debt Discounts, Premiums, and Issuance Costs – Debt discounts and premiums relating to the sale of bonds are amortized over the lives of the related bonds using the constant yield method. Debt issuance costs are amortized over the lives of the related bonds using the effective interest method.

Refunds of Debt – The gain or loss on refunding of debt is amortized over the remaining life of the refunded or newly issued bond, whichever is shorter. If debt is extinguished using the District's own resources, any resulting gain or loss is recognized during the current period.

Unearned Revenue – Contributions in aid of construction that are refundable are recorded as unearned revenue. Additionally, the District has two long-term exchange contracts under which the District received collective prepayments of \$2 million that are being amortized into revenue on a straight-line basis over the life of these agreements.

Revenue Taxes – Utility revenue-based taxes assessed by governmental entities are accounted for as a separate cost collected from customers for remittance to those governmental entities. Therefore, revenue taxes paid to the taxing authorities are accounted for as an operating expense on the Statements of Revenues and Expenses and Changes in Net Position. Taxes collected from customers on behalf of other governmental entities are included in Retail energy sales in the Statements of Revenues and Expenses and Changes in Net Position.

Net Position – The District classifies its net position into three components – Invested in capital assets, net of related debt; Restricted; and Unrestricted. These classifications are defined as follows:

- **Invested in capital assets, net of related debt** – This component of net position consists of capital assets, net of accumulated depreciation reduced by the outstanding debt balances, net of unamortized debt expenses, and related unspent project and debt service funds.
- **Restricted** – This component of net position consists of assets with constraints placed on their use. Constraints include those imposed by debt trust indentures, grants or laws and regulations of other governments, or by law through constitutional provisions or enabling legislation.

PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

NOTES TO THE FINANCIAL STATEMENTS DECEMBER 31, 2012 AND 2011

- *Unrestricted* – This component of net position consists of net assets and liabilities that do not meet the definition of “restricted” or “invested in capital assets, net of related debt.”

Significant Risk and Uncertainties – The District is subject to certain business risks that could have a material impact on future operations and financial performance. These risks include weather and natural-disaster-related disruptions, collective bargaining labor disputes, fish and other Endangered Species Act (“ESA”) issues, Environmental Protection Agency regulations, federal government regulations or orders concerning the operation, maintenance and/or licensing of hydroelectric facilities, and the deregulation of the electrical utility industry.

With regard to liability risk, the District has elected self-insurance for general and auto liability up to \$500,000 per incident. The District has historically had minimal liability claims activity, and estimated claims incurred but not reported are not significant as of December 31, 2012. The District is involved in litigation with results that are uncertain but the risk to the District at this time does not appear significant.

Personal Leave Benefit – Employees of the District accrue a personal leave benefit based upon a years of service schedule. Personal leave may be used for vacation, sick leave, or other employee absences. The District records personal leave as an expense and a liability as earned. Unused personal leave may be accumulated up to a maximum of 1,200 hours for employees who began service prior to April 1, 2011. For employees hired on or after April 1, 2011, the maximum amount of accrued personal leave is 700 hours.

Use of Estimates – The preparation of financial statements, in conformity with accounting principles generally accepted in the United States of America, requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates. The District has used significant estimates in determination of useful lives of DSM, unbilled revenue, Licensing obligations, allowance for uncollectible accounts, Accrued other postemployment benefits, and in the determination of depreciable lives of utility plant.

Energy Risk Management – The District’s power marketing activities are restricted to meeting the District load requirements in excess of expected generation from the Priest Rapids Project and selling power excess to the District’s needs at the best available price. To mitigate risk associated with power marketing activities, the District established the Risk Oversight Committee and adopted the Energy Risk Management Policies and Procedures to provide greater ongoing monitoring and review of power transactions. The Energy Risk Management Policy and Procedures outlines the parameters for transactions, trader and counterparty exposure, and serves as a formal communication to all District employees

PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

NOTES TO THE FINANCIAL STATEMENTS DECEMBER 31, 2012 AND 2011

performing power marketing functions. The District believes that the Energy Risk Management Policy and Procedures, coupled with the Risk Oversight Committee, limits the risk of any substantial financial loss resulting from the District's power supply management activities.

2. CASH AND INVESTMENTS

The District's cash deposits at December 31, 2012 and 2011, were either entirely covered by federal depository insurance or protected against loss by being on deposit with financial institutions recognized as qualified public depositories of the State of Washington under the Revised Code of Washington ("RCW") Chapter 39. Subject to specific bond resolution limitations, management is permitted to invest as provided under the laws of the State of Washington.

Unspent cash, and associated investments, received in connection with bond offerings are maintained in funds as required by the District's bond indentures. Restricted assets represent funds that are restricted by bond covenants or third party contractual agreements. Funds that are allocated by Commission resolution are considered to be board designated funds. Board designated funds are a component of unrestricted assets as their use may be redirected at any time by Commission approval.

PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

NOTES TO THE FINANCIAL STATEMENTS DECEMBER 31, 2012 AND 2011

As of December 31, the District's unrestricted, board designated and restricted assets included on the Statement of Net Position as Cash and Investments, including accrued interest, consisted of the following:

(amounts in thousands)	2012	2011
Unrestricted assets:		
Unrestricted funds:		
Revenue and Service System funds	\$ 69,953	\$ 50,619
Board designated funds:		
Electric System Reserve and Contingency fund	72,070	71,807
Self-Insurance Reserve fund	1,110	1,163
Total board designated funds	<u>73,180</u>	<u>72,970</u>
Total unrestricted funds	<u>143,133</u>	<u>123,589</u>
Restricted:		
Construction funds	176,966	257,923
Bond Sinking funds	55,675	40,942
Debt Service Reserve funds	37,649	32,195
Bond Interest funds	27,479	25,372
Renewal, Replacement and Contingency fund	24,317	23,978
Habitat funds	12,138	10,482
Quincy Chute Renewal and Replacement fund	<u>1,714</u>	<u>1,711</u>
Total restricted funds	<u>335,938</u>	<u>392,603</u>
Total	<u>\$ 479,071</u>	<u>\$ 516,192</u>

Interest Rate Risk – The District has no formal investment policy limitations on investment maturities as a means of managing its exposure to fair value losses arising from increasing interest rates.

Credit Risk – The District has no formal investment policy that specifies credit ratings of potential investment issuers as a means of managing the District's exposure to credit risk.

Concentration of Credit Risk – The District places no limit on the amount the District may invest in any one issuer. All repurchase agreements are brokered by one financial institution. The investments underlying these repurchase agreements are United States Treasury debt securities and, as such, credit ratings are not reported.

PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

NOTES TO THE FINANCIAL STATEMENTS DECEMBER 31, 2012 AND 2011

The District's investments at December 31, 2012 and 2011, as identified on the Statements of Net Position, are shown below by investment type. All investments are either issued or registered in the name of the District or are held by the District or by the District's agent in the District's name. The difference between the totals shown in the previous table and table below is accrued interest of \$1.4 million and \$1.7 million for 2012 and 2011, respectively.

During 2012 and 2011, the District realized \$1.8 million and \$1.9 million of interest earnings and realized gains from investments, respectively. The unrealized gain on investments held at December 31, 2012 and 2011, was \$340,096 and \$1.8 million, respectively.

Investments are made in investment types authorized by the RCW. The types are 1) Obligations of the U.S. Government and its agencies, 2) Repurchase agreements collateralized by U.S. Government obligations, 3) Money market funds that have holdings of or are backed by U.S. Government obligations and 4) Municipal bonds. Investments by type at December 31 were as follows:

(amounts in thousands)	2012	2011
U.S. agencies	\$ 165,854	\$ 207,152
U.S. treasuries	164,871	177,432
Money market funds	56,008	52,522
Repurchase agreements	52,000	52,000
Municipal bonds	13,752	7,726
Total investments	<u>452,485</u>	<u>496,832</u>
Cash	<u>25,183</u>	<u>17,624</u>
Total cash and investments	<u>\$ 477,668</u>	<u>\$ 514,456</u>

PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

NOTES TO THE FINANCIAL STATEMENTS DECEMBER 31, 2012 AND 2011

The District places no limit on the amounts invested in any one issuer for federal agency securities. The following are the concentrations of risk greater than 5%, in either year. The credit ratings listed are from Fitch Ratings as of December 31, 2012. TSY refers to U.S. Treasury securities and N/R means not rated.

	Credit Rating	2012	2011
U.S. treasuries	TSY	37%	36%
FNMA Discount Notes	AA+	15%	17%
Federal Home Loan Mortgage Corp.	n/a	Less than 5%	7%
Money market funds	N/R	12%	11%
Repurchase agreements	N/R	12%	11%
Federal Home Loan Bank	AA+	13%	11%
Federal Farm Credit	AA+	6%	7%

3. UTILITY PLANT

Utility plant of the District as of December 31, is summarized as follows:

(amounts in thousands)	Balance 2011	Additions	Retirements/ Transfers	Balance 2012
Distribution facilities	\$ 409,589	\$ 32,122	\$ (643)	\$ 441,068
Transmission facilities	155,797	6,317	-	162,114
Hydro facilities				
Power plant structures	49,993	7,215	-	57,208
Reservoirs, dams, waterways	408,420	3,049	-	411,469
Power plant equipment	399,539	68,043	(3,551)	464,031
General facilities				
Quincy Chute (Note 6)	17,771	-	-	17,771
Potholes East Canal (Note 6)	16,450	-	-	16,450
Other generation	30	-	-	30
General plant	260,728	37,038	-	297,766
FERC License	110,646	-	-	110,646
Other intangible assets	2,094	3,573	-	5,667
Total	1,831,057	157,357	(4,194)	1,984,220
Accumulated depreciation and amortization	(670,942)	(48,435)	4,194	(715,183)
Subtotal	1,160,115	108,922	-	1,269,037
Land and land rights	24,577	-	-	24,577
Construction in progress	223,371	151,995	(153,441)	221,925
Total net utility plant	\$ 1,408,063	\$ 260,917	\$ (153,441)	\$ 1,515,539

PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

NOTES TO THE FINANCIAL STATEMENTS DECEMBER 31, 2012 AND 2011

(amounts in thousands)	Balance 2010	Additions	Retirements/ Transfers	Balance 2011
Distribution facilities	\$ 390,325	\$ 20,404	\$ (1,140)	\$ 409,589
Transmission facilities	154,943	854	-	155,797
Hydro facilities				
Power plant structures	46,775	3,218	-	49,993
Reservoirs, dams, waterways	373,146	35,274	-	408,420
Power plant equipment	337,478	63,836	(1,775)	399,539
General facilities				
Quincy Chute (Note 6)	17,683	88	-	17,771
Potholes East Canal (Note 6)	16,389	61	-	16,450
Other generation	30	-	-	30
General plant	251,382	9,360	(14)	260,728
FERC License	110,646	-	-	110,646
Other intangible assets	1,648	446	-	2,094
Total	1,700,445	133,541	(2,929)	1,831,057
Accumulated depreciation and amortization	(627,848)	(46,023)	2,929	(670,942)
Subtotal	1,072,597	87,518	-	1,160,115
Land and land rights	24,572	11	(6)	24,577
Construction in progress	233,578	122,217	(132,424)	223,371
Total net utility plant	<u>\$ 1,330,747</u>	<u>\$ 209,746</u>	<u>\$ (132,430)</u>	<u>\$ 1,408,063</u>

4. LICENSING

The Priest Rapids Project is operated under a 44-year FERC license that expires in 2052.

Costs associated with the relicensing efforts, totaling \$57.1 million, were recorded as an intangible asset included in Utility plant and are being amortized over the term of the license.

Under the license, the District is committed to numerous obligations related to fish and habitat protection which require payments to other organizations using funds provided by the District. The present value of these obligations totaled \$50.2 million as of December 31, 2012, of which approximately \$3.6 million is expected to be paid within one year. The present value of the obligations was \$51.1 million as of December 31, 2011. These amounts are included in the FERC license balance and are reflected as liabilities in the statement of net position. The elements of these obligating payments, comprising the Salmon and Steelhead Agreement, Part A (Hatchery Renovation) and Part B (Resident Fish Monitoring and Trout Purchase), are further discussed in Note 7.

PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

NOTES TO THE FINANCIAL STATEMENTS DECEMBER 31, 2012 AND 2011

5. REVENUE BONDS

In May of 2012, the District issued \$127.6 million of revenue and refunding bonds, at a net premium of \$11.7 million, associated with the Priest Rapids Project to finance improvements at the Priest Rapids Project, to refund certain bonds previously issued, to pay issuance costs, and to fund a debt service reserve. The refunded portion of \$88.6 million will yield a net present value savings of \$9.5 million. The District also realized a \$5.4 million refunding loss associated with unamortized discounts/premiums, and bond issuance costs.

In September of 2011, the District used cash reserves to defease \$53 million of the Electric System 2001-H bonds. In October of 2011, the District also issued \$156.1 million of revenue and refunding bonds, at a net premium of \$20.8 million, associated with the Electric System to finance improvements in the Electric System, to refund certain bonds previously issued, to pay issuance costs, and to fund a debt service reserve. The refunded portion of \$62.8 million will yield a net present value savings of \$5.9 million. The District also realized a \$561,493 refunding loss associated with unamortized discounts/premiums, and bond issuance costs.

All the outstanding issues, which are on parity with each other, are fixed rate obligations secured by a pledge of the net revenues of the District. See Note 12.

The District's outstanding revenue bonds as of December 31 were as follows:

(amounts in thousands)	2012	2011
Electric System, interest rates of 3.0% to 5.0%, maturing through 2023	\$ 151,735	\$ 156,070
Priest Rapids Project, interest rates of .55% to 5.83%, maturing through 2043	<u>928,940</u>	<u>917,060</u>
Total revenue bonds outstanding	<u>\$ 1,080,675</u>	<u>\$ 1,073,130</u>

PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

NOTES TO THE FINANCIAL STATEMENTS DECEMBER 31, 2012 AND 2011

Scheduled debt service requirements for the District's bonds are as follows:

(amounts in thousands)	Principal	Interest	Total
2013	\$ 38,865	\$ 53,867	\$ 92,732
2014	41,095	51,900	92,995
2015	39,590	50,066	89,656
2016	41,450	48,267	89,717
2017	43,195	46,346	89,541
2018 - 2022	216,180	200,104	416,284
2023 - 2027	216,055	153,144	369,199
2028 - 2032	194,280	95,464	289,744
2033 - 2037	147,045	47,916	194,961
2038 - 2043	102,920	12,530	115,450
Total	<u>\$ 1,080,675</u>	<u>\$ 759,604</u>	<u>\$ 1,840,279</u>

For the years ending December 31, 2012 and 2011, the District is in compliance with all debt covenants related to the outstanding bonds, which includes a minimum debt service coverage of 1.15x and 1.25x for the Priest Rapids Project bonds and Electric System bonds, respectively.

PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

NOTES TO THE FINANCIAL STATEMENTS DECEMBER 31, 2012 AND 2011

During the years ended December 31, the following changes occurred in the District's long-term debt:

(amounts in thousands)	Balance 2011	Additions	Reductions	Balance 2012	Due Within One Year
Revenue bonds payable	\$ 1,073,130	\$ 127,620	\$ (120,075)	\$ 1,080,675	\$ 38,865
Unamortized premiums and discounts, net	28,053	11,741	(5,443)	34,351	-
Unamortized refunding loss	(6,732)	(5,438)	2,985	(9,185)	-
Total	\$ 1,094,451	\$ 133,923	\$ (122,533)	\$ 1,105,841	\$ 38,865

(amounts in thousands)	Balance 2010	Additions	Reductions	Balance 2011	Due Within One Year
Revenue bonds payable	\$ 1,068,685	\$ 156,070	\$ (151,625)	\$ 1,073,130	\$ 31,520
Unamortized premiums and discounts, net	12,016	20,801	(4,764)	28,053	-
Unamortized refunding loss	(8,283)	(259)	1,810	(6,732)	-
Total	\$ 1,072,418	\$ 176,612	\$ (154,579)	\$ 1,094,451	\$ 31,520

6. POWER PURCHASER COMMITMENTS

Priest Rapids Project

Under the Priest Rapids Power Sales Contracts, the amount of net power costs incurred by the District in serving its load changes on an annual basis in relation to its firm power requirements. For 2012 and 2011, the District incurred 61% and 62% of Priest Rapids Project power costs with power purchasers funding 39% and 38%, respectively.

From November 1, 2005, through September 30, 2011, under the provisions in the power sales contracts, the District sold a portion of the Priest Rapids Project generation to displace the costs of purchasing BPA power. The net effect to the District was that the BPA portion of the District's load was served at Priest Rapids Project power cost. Effective October 1, 2011, that portion of the power sales contract came to an end. With the expiration of the current

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BPA contract, as discussed below, the District retains the Priest Rapids Project generation it would otherwise have sold as a displacement to power costs. The District is therefore left in the same net resource and economic position.

Each purchaser is obligated to pay its share of the cost (excluding depreciation and amortization) of producing and delivering power, plus 115% of its share of the amounts required for debt service payments.

BPA

The District is a statutory preference customer of BPA. The District purchased power and transmission from BPA under contracts which expired September 30, 2011. BPA and the District agreed to a Shaped Block Purchase under which the District received 197 average megawatts (“aMW”) of energy for 9 months and 188 aMW of energy for 12 months for 2011 and 2010, respectively. The District also purchased approximately 5 aMW of energy for the Grand Coulee load during those periods. Block deliveries were fixed at a flat rate within each month, but predetermined at different levels each month to more closely follow anticipated seasonal load requirements. The District had 252 megawatts (“MW”) of transmission associated with this block purchase, which also expired on September 30, 2011. The District signed a follow-up contract during 2008 to serve its Grand Coulee load of approximately 5 aMW that expires September 30, 2028. The District has transmission to deliver the power associated with this load through September 30, 2028. In 2009, the District entered into a five-year agreement for 150 MW of Long-Term Firm (LTF) power with a security deposit of \$2.3 million for transmission services commencing January 1, 2011. The \$2.3 million deposit was reimbursed to the District during the first year of the contract. Rollover rights are included as part of this agreement. In 2010, the District exercised rollover rights associated with 12 MW of transmission for the delivery of power from the Nine Canyon Wind Project in order to extend the term of the reservation to October 1, 2030. In 2011, the District entered into a 2-year contract with BPA for 250 MW of transmission that expires on September 30, 2013. The District does not anticipate replacing this transmission long-term and plans to rely on the new 230 kV line which is scheduled for completion in 2014.

District management estimates the District’s minimum commitments to BPA for the next five years are as follows:

Estimated BPA Contractual Payments

(amounts in thousands)

2013	\$	5,337
2014		2,688
2015		2,723
2016		2,110
2017		2,324

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Nine Canyon Wind Power Purchase Agreement

The District participates in a power purchase agreement with Energy Northwest for Phase I of the Nine Canyon Wind Project (the “Project”) which consists of 37 wind turbines with an aggregate generating capacity of approximately 48 MW. Energy Northwest is a municipal corporation and a joint operating agency of the State of Washington (formerly known as the Washington Public Power Supply System). The District does not participate in the two other phases of the Project which comprise additional generation capacity of approximately 48 MW. The phases are operated together as a single project under an amended power purchase agreement.

The District is one of nine public agencies participating in the original project power purchase agreement for Phase I of the Project. The District’s purchaser share of Phase I of the project output was 25% of output up to a maximum of 12 MW. Since the District did not participate in either Phase II or Phase III of the Project, its share of the combined Project is 12.54%. In exchange for the output, the District pays its proportionate share of certain Project costs and its 25% share of Phase I debt service.

Scheduled debt service requirements, inclusive of principal and interest, for the District’s 25% share of the bonds as well as certain other Project costs are estimated at \$2.1 million annually.

Yakama Nation Agreement

In 2007, the District entered into an agreement with the Yakama Nation that provides mutual benefits to both parties. In exchange for physical benefits from the Priest Rapids Project, the Yakama Nation will work collaboratively with the District on environmental issues affecting the project and in the development of new generation resources. The Yakama Nation is responsible to pay the costs associated with producing the benefit received.

The net payments to the Yakama Nation totaled \$422,898 and \$825,668 during 2012 and 2011, respectively. The estimated cost for this agreement is approximately \$1.7 million for 2013. The projected average annual cost for this agreement from 2014 to 2018 is approximately \$2 million. The agreement expires at the end of the FERC license term (2052).

Other Sources

Pursuant to agreements with three irrigation districts, the District constructed, operates, and maintains both the Quincy Chute and Potholes East Canal hydroelectric generation facilities in return for the right to all output from the projects. The construction costs of Quincy Chute and Potholes East Canal are included in Net utility plant and are being amortized over the terms of the agreements, which expire October 1, 2025, and September 1, 2030, respectively. The irrigation districts hold title to the project facilities.

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7. NONPOWER COMMITMENTS

Capital Projects

The District has contractual commitments relating to several Electric System capital improvement projects including fiber design/build, software replacement, electrical system upgrades, multiple transformer purchases, power cable purchases, and substation and distribution line construction projects over the next few years totaling approximately \$59.3 million as of December 31, 2012.

The District's improvement programs for the Priest Rapids Project include restoration or replacement of generators and turbines, deleading and painting of six turbines, construction and upgrades to the maintenance and warehouse center, construction of a fish bypass project, and supplying transformers and digital hydraulic controls for the governor system as well as motor control centers. The District intends to, or has committed by contract to, fulfill these programs, which are projected to be substantially complete by 2018. The contractually committed amount on future Priest Rapids Project work to be performed on these major capital programs is approximately \$167.6 million as of December 31, 2012.

Other Commitments

In 2006, the District entered into a Salmon and Steelhead Settlement Agreement with the United States Department of Interior, U.S. Fish and Wildlife Service, the National Marine Fisheries Service of the National Oceanic and Atmospheric Administration (NOAA), the Washington Department of Fish and Wildlife, the Yakama Nation, and the Confederated Tribes of the Colville Reservation for the purpose of resolving all issues between the District and the other signatories related to anadromous salmonid fish species. This agreement is intended to constitute a comprehensive and long-term adaptive management program for the protection, mitigation, and enhancement of anadromous fish (both listed and not listed species under the Endangered Species Act; ESA) which pass or may be affected by the Priest Rapids Project.

Under the Salmon and Steelhead Settlement Agreement, the District is obligated to establish a habitat conservation account and a no-net-impact fund (referred herein as "Habitat funds") into which the District deposits payments for further distribution in accordance with the requirements of the Salmon and Steelhead Agreement. The purpose of the Habitat funds are two-fold; (1) to establish and shepherd a habitat restoration program that promotes the rebuilding of self-sustaining and harvestable populations of anadromous species and to mitigate for a portion (2%) of unavoidable losses resulting from the Priest Rapids Project operations and (2) to provide near-term compensation for annual survivals that are less than the survival objectives in the performance standards for the Priest Rapids Project for spring Chinook, steelhead, summer Chinook, and sockeye. The parties that oversee the distribution of these funds include the signatories to the Priest Rapids Salmon and Steelhead Settlement Agreement (U.S. Fish and Wildlife Service, NOAA Fisheries, Washington Department of Fish and Wildlife, Confederated Colville Tribes, Yakama Nation, and the District).

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In addition to the Habitat funds discussed above, the District is obligated to establish a habitat account into which the District deposits payments for further distribution in accordance with the requirements of the NOAA Fisheries 2008 Biological Opinion (“2008 BiOp”) for the Priest Rapids Project. Funds from this account are used for habitat actions that directly benefit Upper Columbia River (“UCR”) spring-run Chinook salmon and UCR steelhead. The parties identified above and the Confederated Tribes of the Umatilla Reservation have been identified in the 2008 BiOp as responsible for overseeing distribution of these funds.

The Habitat funds are restricted and cannot be spent without unanimous consent. Interest earned by the Habitat funds increases the balance of these funds and is not recognized as income by the District. Expenditures of these funds are made in accordance with the Salmon and Steelhead Settlement Agreement and the 2008 NOAA Fisheries BiOp for the protection and restoration of habitats along the mainstem and tributaries within the UCR watershed including the Okanogan, Methow, Entiat, and Wenatchee watersheds. The District anticipates funding these accounts up to and through the term of its FERC license.

In October of 2006, the District filed a request for a 401 Water Quality Certification (“401 WQC”) from the Washington State Department of Ecology (“Ecology”), pursuant to the provisions of section 401 of the Clean Water Act. A 401 WQC for the operation of the Priest Rapids Project was issued by Ecology on April 3, 2007, and amended on March 6, 2008.

In order to fulfill requirements of the 401 WQC related to native resident fish, the District is required to provide funds to track native resident fish species diversity and provide mitigation for impacts to and loss of resident fish and harvest opportunities by compliance with Parts A and B as described below.

To remain in compliance under Part A (“Hatchery Renovation”), the District is required to provide funds (not to exceed \$1.5 million) to renovate the existing Columbia Basin Hatchery facility to ensure stable operations at current capacity for the term of the license. Current capacity is 60,000-70,000 pounds of trout annually, which shall be credited to the District as mitigation for reduced recreational fishing opportunities occurring on native resident fish species. Under Part B (“Resident Fish Monitoring and Trout Purchase”), the District is obligated to establish and administer a fund for resident fish monitoring and fish purchase. Funds from Part B are specifically directed toward the monitoring of native resident fish species within the Priest Rapids Project area. The District is required to make contributions to the fund annually on or before February 15 of each year in the amount of \$100,000 per year, based upon 2003 dollars and annually adjusted for inflation.

In a FERC Order (issued on August 31, 2010) approving the Wildlife Habitat Management Plan (Article 409), the District is required to assist the Washington Department of Fish and Wildlife in fire suppression by contributing \$40,000 annually to an account. Funds from the account are to be designated for: 1) revegetating burned areas; 2) revegetating areas known to burn frequently with species carrying lesser fuel loads; 3) creating fire breaks in appropriate locations; and 4) paying for firefighting activities.

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The District's total contributions to these Habitat funds for the years ended December 31, 2012, and December 31, 2011, equaled \$3.4 million and \$5.6 million, respectively. These contributions reduced the Licensing obligations, as discussed in Note 4.

The following table shows the District's estimate of the remaining fixed contributions to the Habitat funds as of December 31, 2012, representing required contributions through the New License term.

Estimated Fixed Habitat Funding Commitments

(amounts in thousands)

2013	\$	3,646
2014		3,720
2015		3,796
2016		3,693
2017		3,701
2018 and thereafter		93,182
Total	\$	<u>111,738</u>

Participation In Northwest Open Access Network, Inc. D.B.A. NoaNet - The District, along with 11 other Washington State Public Utility Districts and Energy Northwest, is a member of NoaNet, a Washington nonprofit mutual corporation. NoaNet provides a broadband communications backbone, over Public Benefit Fibers leased from BPA, throughout the State of Washington to assist its members in the efficient management of load, conservation, and acquisition of electric energy as well as other purposes.

NoaNet has issued revenue bonds, the balance of which as of December 31, 2012, was \$10.8 million. Each member of NoaNet has entered into a repayment agreement to guarantee the bonds of NoaNet. The District's guarantee is limited to a maximum of 14.17% of the bonds.

The management of NoaNet anticipates meeting its cost of operations through revenues, thus no annual assessment for 2012 was needed.

For the NoaNet final 2012 financial report, please contact: NoaNet, Accounting Department, 4312 Kitsap Way, Suite 101, Bremerton, WA 98312.

The NoaNet financial report is the responsibility of NoaNet. The independent auditor for the District has not audited or examined any information in the financial report, and accordingly, does not express an opinion or any other form of assurance with respect thereto.

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NOTES TO THE FINANCIAL STATEMENTS DECEMBER 31, 2012 AND 2011

8. PENSION / RETIREMENT PLAN

Substantially all the District's full-time and qualifying part-time employees participate in one of the following statewide retirement systems administered by the Washington State Department of Retirement Systems, under cost-sharing multiple-employer public employee defined benefit retirement plans. The Department of Retirement Systems (DRS), a department within the primary government of the State of Washington, issues a publicly available comprehensive annual financial report (CAFR) that includes financial statements and required supplementary information for each plan. The DRS CAFR may be obtained by writing to: Department of Retirement Systems, Communications Unit, P.O. Box 48380, Olympia, WA 98504-8380; or it may be downloaded from the DRS website at www.drs.wa.gov. The independent auditor for the District has not audited or examined any information in the CAFR, and accordingly, does not express an opinion or any other form of assurance with respect thereto. The following disclosures are made pursuant to GASB Statements No. 27, *Accounting for Pensions by State and Local Government Employers* and No. 50, *Pension Disclosures, an Amendment of GASB Statements No. 25 and No. 27*.

Public Employees' Retirement System (PERS) Plans 1, 2, and 3

Plan Description

The Legislature established PERS in 1947. Membership in the system includes: elected officials; state employees; employees of the Supreme, Appeals, and Superior courts (other than judges currently in the Judicial Retirement System); employees of legislative committees; community and technical colleges, college and university employees not participating in higher education retirement programs; judges of district and municipal courts; and employees of local governments. PERS retirement benefit provisions are established in Chapters 41.34 and 41.40 RCW and may be amended only by the State Legislature.

PERS is a cost-sharing multiple-employer retirement system comprised of three separate plans for membership purposes: Plans 1 and 2 are defined benefit plans and Plan 3 is a defined benefit plan with a defined contribution component.

PERS members who joined the system by September 30, 1977, are Plan 1 members. Those who joined on or after October 1, 1977, and by either, February 28, 2002, for state and higher education employees, or August 31, 2002, for local government employees, are Plan 2 members unless they exercised an option to transfer their membership to Plan 3. PERS members joining the system on or after March 1, 2002, for state and higher education employees, or September 1, 2002, for local government employees have the irrevocable option of choosing membership in either PERS Plan 2 or PERS Plan 3. The option must be exercised within 90 days of employment. An employee is reported in Plan 2 until a choice is made. Employees who fail to choose within 90 days default to PERS Plan 3. Notwithstanding, PERS Plan 2 and Plan 3 members may opt out of plan membership if terminally ill, with less than five years to live.

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PERS Plan 1 and Plan 2 defined benefit retirement benefits are financed from a combination of investment earnings and employer and employee contributions.

PERS Plan 1 members are vested after the completion of five years of eligible service. Plan 1 members are eligible for retirement after 30 years of service, or at the age of 60 with five years of service, or at the age of 55 with 25 years of service. The monthly benefit is 2 percent of the average final compensation (AFC) per year of service. (AFC is the monthly average of the 24 consecutive highest-paid service credit months.) The retirement benefit may not exceed 60 percent of AFC. The monthly benefit is subject to a minimum for PERS Plan 1 retirees who have 25 years of service and have been retired 20 years, or who have 20 years of service and have been retired 25 years. Plan 1 members retiring from inactive status prior to the age of 65 may receive actuarially reduced benefits. If a survivor option is chosen, the benefit is further reduced. A cost-of-living allowance (COLA) was granted at age 66 based upon years of service times the COLA amount. This benefit was eliminated by the Legislature, effective July 1, 2011. Plan 1 members may elect to receive an optional COLA that provides an automatic annual adjustment based on the Consumer Price Index. The adjustment is capped at 3 percent annually. To offset the cost of this annual adjustment, the benefit is reduced.

PERS Plan 1 provides duty and non-duty disability benefits. Duty disability retirement benefits for disablement prior to the age of 60 consist of a temporary life annuity payable to the age of 60. The allowance amount is \$350 a month, or two-thirds of the monthly AFC, whichever is less. The benefit is reduced by any workers' compensation benefit and is payable as long as the member remains disabled or until the member attains the age of 60. A member with five years of covered employment is eligible for non-duty disability retirement. Prior to the age of 55, the allowance amount is 2 percent of the AFC for each year of service reduced by 2 percent for each year that the member's age is less than 55. The total benefit is limited to 60 percent of the AFC and is actuarially reduced to reflect the choice of a survivor option. A cost-of-living allowance was granted at age 66 based upon years of service times the COLA amount. This benefit was eliminated by the Legislature, effective July 1, 2011. Plan 1 members may elect to receive an optional COLA that provides an automatic annual adjustment based on the Consumer Price Index. The adjustment is capped at 3 percent annually. To offset the cost of this annual adjustment, the benefit is reduced.

PERS Plan 1 members can receive credit for military service. Members can also purchase up to 24 months of service credit lost because of an on-the-job injury.

PERS Plan 2 members are vested after the completion of five years of eligible service. Plan 2 members are eligible for normal retirement at the age of 65 with five years of service. The monthly benefit is 2 percent of the AFC per year of service. (AFC is the monthly average of the 60 consecutive highest-paid service months.)

PERS Plan 2 members who have at least 20 years of service credit and are 55 years of age or older are eligible for early retirement with a reduced benefit. The benefit is reduced by an early retirement factor (ERF) that varies according to age, for each year before age 65.

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PERS Plan 2 members who have 30 or more years of service credit and are at least 55 years old can retire under one of two provisions:

- With a benefit that is reduced by 3 percent for each year before age 65.
- With a benefit that has a smaller (or no) reduction (depending on age) that imposes stricter return-to-work rules.

PERS Plan 2 retirement benefits are also actuarially reduced to reflect the choice, if made, of a survivor option. There is no cap on years of service credit; and a cost-of-living allowance is granted (based on the Consumer Price Index), capped at 3 percent annually.

The surviving spouse or eligible child or children of a PERS Plan 2 member who dies after leaving eligible employment having earned ten years of service credit may request a refund of the member's accumulated contributions.

PERS Plan 3 has a dual benefit structure. Employer contributions finance a defined benefit component and member contributions finance a defined contribution component. The defined benefit portion provides a monthly benefit that is 1 percent of the AFC per year of service. (AFC is the monthly average of the 60 consecutive highest-paid service months.)

Effective June 7, 2006, PERS Plan 3 members are vested in the defined benefit portion of their plan after ten years of service; or after five years of service, if twelve months of that service are earned after age 44; or after five service credit years earned in PERS Plan 2 prior to June 1, 2003. Plan 3 members are immediately vested in the defined contribution portion of their plan.

Vested Plan 3 members are eligible for normal retirement at age 65, or they may retire early with the following conditions and benefits:

- If they have at least ten service credit years and are 55 years old, the benefit is reduced by an ERF that varies with age, for each year before age 65.
- If they have 30 service credit years and are at least 55 years old, they have the choice of a benefit that is reduced by 3 percent for each year before age 65; or a benefit with a smaller (or no) reduction factor (depending on age) that imposes stricter return-to-work rules.

PERS Plan 3 defined benefit retirement benefits are also actuarially reduced to reflect the choice, if made, of a survivor option. There is no cap on years of service credit and Plan 3 provides the same cost-of-living allowance as Plan 2.

PERS Plan 3 defined contribution retirement benefits are solely dependent upon contributions and the results of investment activities.

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The defined contribution portion can be distributed in accordance with an option selected by the member, either as a lump sum or pursuant to other options authorized by the Director of the Department of Retirement Systems.

PERS Plan 2 and Plan 3 provide disability benefits. There is no minimum amount of service credit required for eligibility. The Plan 2 monthly benefit amount is 2 percent of the AFC per year of service. For Plan 3, the monthly benefit amount is 1 percent of the AFC per year of service.

These disability benefit amounts are actuarially reduced for each year that the member's age is less than 65, and to reflect the choice of a survivor option. There is no cap on years of service credit, and a cost-of-living allowance is granted (based on the Consumer Price Index) capped at 3 percent annually.

PERS Plan 2 and Plan 3 members may have up to ten years of interruptive military service credit; five years at no cost and five years that may be purchased by paying the required contributions. Effective July 24, 2005, a member who becomes totally incapacitated for continued employment while serving the uniformed services, or a surviving spouse or eligible children, may apply for interruptive military service credit. Additionally, PERS Plan 2 and Plan 3 members can also purchase up to 24 months of service credit lost because of an on-the-job injury.

PERS members may also purchase up to five years of additional service credit once eligible for retirement. This credit can only be purchased at the time of retirement and can be used only to provide the member with a monthly annuity that is paid in addition to the member's retirement benefit.

Beneficiaries of a PERS Plan 2 or Plan 3 member with ten years of service who is killed in the course of employment receive retirement benefits without actuarial reduction, if the member was not at normal retirement age at death. This provision applies to any member killed in the course of employment, on or after June 10, 2004, if found eligible by the Department of Labor and Industries.

A one-time duty-related death benefit is provided to the estate (or duly designated nominee) of a PERS member who dies in the line of service as a result of injuries sustained in the course of employment, or if the death resulted from an occupational disease or infection that arose naturally and proximately out of said member's covered employment, if found eligible by the Department of Labor and Industries.

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There are 1,197 participating employers in PERS. Membership in PERS consisted of the following as of the latest actuarial valuation date for the plans of June 30, 2011:

Retirees and Beneficiaries Receiving Benefits	79,363
Terminated Plan Members Entitled to But Not Yet Receiving Benefits	29,925
Active Plan Members Vested	105,578
Active Plan Members Nonvested	46,839
	<hr/>
Total	261,705
	<hr/>

Funding Policy

Each biennium, the state Pension Funding Council adopts PERS Plan 1 employer contribution rates, PERS Plan 2 employer and employee contribution rates, and PERS Plan 3 employer contribution rates. Employee contribution rates for Plan 1 are established by statute at 6 percent for state agencies and local government unit employees, and at 7.5 percent for state government elected officials. The employer and employee contribution rates for Plan 2 and the employer contribution rate for Plan 3 are developed by the Office of the State Actuary to fully fund Plan 2 and the defined benefit portion of Plan 3. All employers are required to contribute at the level established by the Legislature. Under PERS Plan 3, employer contributions finance the defined benefit portion of the plan and member contributions finance the defined contribution portion. The Plan 3 employee contribution rates range from 5 percent to 15 percent, based on member choice. Two of the options are graduated rates dependent on the employee's age. As a result of the implementation of the Judicial Benefit Multiplier Program in January of 2007, a second tier of employer and employee rates was developed to fund, along with investment earnings, the increased retirement benefits of those justices and judges who participate in the program.

The methods used to determine the contribution requirements are established under state statute in accordance with Chapters 41.40 and 41.45 RCW.

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The required contribution rates expressed as a percentage of current-year covered payroll, as of December 31, 2011, were as follows:

	PERS Plan 1	PERS Plan 2	PERS Plan 3
Employer*	7.25%**	7.25%**	7.25%***
Employee	6.00%****	4.64%****	*****

* The employer rates include the employer administrative expense fee currently set at 0.16%.

** The employer rate for state elected officials is 10.80% for Plan 1 and 7.25% for Plan 2 and Plan 3.

*** Plan 3 defined benefit portion only.

**** The employee rate for state elected officials is 7.50% for Plan 1 and 4.64% for Plan 2.

***** Variable from 5.0% minimum to 15.0% maximum based on rate selected by the PERS 3 member.

Both the District and the employees made the required contributions. The District's required contributions for the years ended December 31, were as follows:

(amounts in thousands)	PERS Plan 1	PERS Plan 2	PERS Plan 3
2012	\$ 356	\$ 3,269	\$ 854
2011	211	2,747	727
2010	147	2,378	628

Deferred Compensation Plan – The District has an Internal Revenue Code Section 457 (b) deferred compensation program covering eligible employees as defined in the plan document. Participants may contribute and defer, up to defined limits, a portion of their current year's salary. The deferred compensation is held in trust and is not available to employees until termination, retirement, death, or unforeseeable emergency. The program includes a loan provision in accordance with IRS guidelines. All plan assets are held in trust for the exclusive benefit of participants and their beneficiaries and therefore are not included in the District's financial statements.

Additionally, the District administers the Public Utility District No. 2 of Grant County's 401(a) Governmental Money Purchase Plan and Trust (fixed and variable plan). Eligible employees can elect to either contribute to the Section 457 deferred compensation plan (variable) or the 401(a) defined contribution plan (fixed). The District's matching employer contributions (50 cents per one dollar of employee contributions) are deposited into the 401(a) plan. The District's match is capped at 2% of straight-time employee wages for the pay period. The District made matching contributions of \$842,426 and \$867,890 in 2012 and 2011, respectively.

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9. POST-EMPLOYMENT BENEFITS OTHER THAN PENSIONS (“OPEB”)

Plan Description

The District administers a single-employer defined benefit premium program (“the retiree subsidy plan”). The plan provides a subsidy that covers a portion of healthcare insurance for retirees ages 59½ to 65 and their spouses. The retiree subsidy plan may be amended through collective bargaining (for bargaining unit employees) and ratified by the District’s Commission, or changed without bargaining for non-unit employees. The retiree subsidy plan does not issue a publicly available financial report.

Funding Policy

The District pays a percentage of the medical premiums based upon years of service of the retirees. At the age of 59½, the retiree is eligible for a subsidy of 3% of their premium cost for each year of service (including any partial year during the year of retirement) up to 30 years (years x 3% x retiree premium). The subsidy cannot be more than the premium amount paid for active employees and is effective until the retiree turns 65. For the years ended December 31, 2012 and 2011, the District paid approximately \$286,000 and \$294,000 in retiree subsidies, respectively.

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Annual OPEB Cost and Net Obligation

The District's annual OPEB cost (expense) is calculated based on the annual required contribution ("ARC") of the employer. The District's ARC and related information is based upon an actuarial valuation as required by GASB Statement No. 45. As of year-end, the net OPEB obligation represents the cumulative difference in ARC and payments made through the plan since actuarial accounting began in 2007. The following table shows the components of the District's annual OPEB cost for the years ended December 31, 2012 and 2011:

(amounts in thousands)	2012	2011
Normal cost with interest	\$ 187	\$ 178
Amortization amount with interest	<u>271</u>	<u>265</u>
Annual required contribution	<u>\$ 458</u>	<u>\$ 443</u>
Annual OPEB cost	\$ 458	\$ 443
Less: benefit payments	<u>(286)</u>	<u>(294)</u>
Increase in net OPEB obligation	172	149
Net OPEB obligation at beginning of year	<u>1,068</u>	<u>919</u>
Net OPEB obligation at end of year	<u>\$ 1,240</u>	<u>\$ 1,068</u>

Funded Status and Funding Progress

As of December 31, 2012 and 2011, the District's Actuarial Accrued Liability ("AAL") was \$4.2 million and \$4.1 million, respectively, all of which was unfunded. The District has no plans at this time to fund the obligation using an irrevocable trust. The AAL is being amortized over a 30-year period and the increase in net OPEB obligation is accrued each year and is split between the District systems, based on current labor allocations. For 2012 and 2011, the covered payroll (annual payroll of active employees covered by the plan) was \$52.5 million and \$50.7 million, respectively, and the ratio of the unfunded obligation to the covered payroll was 8.0% and 8.1%, respectively.

The projection of future benefit payments for an ongoing plan involves estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality, and the healthcare cost trend. Amounts determined regarding the funded status of the plan and annual required

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NOTES TO THE FINANCIAL STATEMENTS DECEMBER 31, 2012 AND 2011

contributions of the employer are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future.

Methods and Assumptions

Projections of benefits for financial reporting purposes are based on the substantive plan (the plan as understood by the employer and plan members) and include the types of benefits provided at the time of the valuation and the sharing of benefit costs between the employer and plan members in effect at the time of the valuation which was December 31, 2011. The actuarial results were calculated based on the Projected Unit Credit actuarial funding method. The methods and assumptions used include techniques that are designed to reduce the effect of short-term volatility in actuarial accrued liabilities and the actuarial value of assets, consistent with the long-term perspective of the calculations.

The following are the significant assumptions related to the plan's actuarial liability:

Retirement age for active employees – Based on assumptions used by PERS but adjusted to reflect expected future rates of retirement based on current experience of the District.

Mortality – Life expectancies were based on the Internal Revenue Code 4030 for 2012 mortality table for annuitants and non-annuitants.

Medical trends – Premium increases of 9.5% in 2011 and declining percentages in future years. It is assumed that the monthly premium and maximum employer subsidy amounts will increase at a slower rate than future claims in the immediate future.

Discount rate – The discount rate of 5.0% that was used in the valuation represents the expected long-term return on short-term U.S. Treasury securities and similar investments. This rate is used because the Plan is “unfunded” and the District's assets would be used to pay benefits.

10. CONTINGENCIES

The District is involved in various claims arising in the normal course of business. The District does not believe that the ultimate outcome of these matters will have a material impact on its financial position, results of operations, or cash flows.

11. SUPPLEMENTAL DISCLOSURE OF TELECOMMUNICATION ACTIVITIES

As described in Note 7, the District, along with 11 other Washington public utility districts and Energy Northwest, is a member of Northwest Open Access Network (“NoaNet”), a Washington nonprofit mutual corporation.

The District is installing a fiber optic distribution system in its service area. As of December 31, 2012, the budgeted build out is 68% complete. This fiber optic distribution system is connected to NoaNet's fiber optic communication system. The District has made capacity on

PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

NOTES TO THE FINANCIAL STATEMENTS DECEMBER 31, 2012 AND 2011

this system available to providers of high speed Internet services and telephone services, among others.

A summary of the financial position and results of operations of the wholesale fiber optic network activities as of and for the years ended December 31, are as follows:

(amounts in thousands)	2012	2011
Operating revenues		
Wholesale fiber services	\$ 3,439	\$ 3,215
Dark fiber revenue	<u>394</u>	<u>200</u>
Wholesale fiber optic network sales	<u>\$ 3,833</u>	<u>\$ 3,415</u>
Operating expenses		
Administrative and general	\$ 458	\$ 557
Repairs and maintenance	832	657
Depreciation	<u>6,065</u>	<u>6,972</u>
Total operating expenses	<u>\$ 7,355</u>	<u>\$ 8,186</u>
Nonoperating revenues		
Contributions in aid of construction	\$ 100	\$ 127
Utility plant		
Additions to utility plant	\$ 11,235	\$ 5,112
Utility plant, net of accumulated depreciation	\$ 77,752	\$ 72,582

12. SEGMENTS

The District has outstanding revenue bonds used to finance the Electric System, and the Priest Rapids Project hydroelectric production facilities. As described in Note 5, all the outstanding bond issues, which are on parity with each other, are secured by a pledge of the net revenues of the District. The Electric System has committed to cover, without limitation, any costs incurred by the Priest Rapids Project that are not covered by purchasers other than the District.

Each system has an external requirement to be accounted for separately. The following condensed financial schedules of the operating segments of the District include the Electric System and the Priest Rapids Project. The District's Service System, as well as eliminating internal transactions, is presented as "Other" in order to reconcile to the combined District's results. "Other" is not considered a segment of the District.

PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

NOTE 12 - SEGMENTS DECEMBER 31, 2012

CONDENSED STATEMENT OF NET POSITION

(AMOUNTS IN THOUSANDS)	Electric System	Priest Rapids Project	Other	Total
ASSETS				
Total current assets	\$ 155,062	\$ 96,925	\$ (23,875)	\$ 228,112
Net utility plant	495,034	1,020,505	-	1,515,539
Noncurrent	113,369	193,557	-	306,926
TOTAL ASSETS	\$ 763,465	\$ 1,310,987	\$ (23,875)	\$ 2,050,577
LIABILITIES				
Current	\$ 36,134	\$ 129,766	\$ (23,875)	\$ 142,025
Noncurrent	158,848	957,311	-	1,116,159
TOTAL LIABILITIES	194,982	1,087,077	(23,875)	1,258,184
NET POSITION				
Invested in capital assets, net of related debt	382,114	149,680	-	531,794
Restricted	24,626	70,425	-	95,051
Unrestricted	161,743	3,805	-	165,548
TOTAL NET POSITION	568,483	223,910	-	792,393
TOTAL LIABILITIES AND NET POSITION	\$ 763,465	\$ 1,310,987	\$ (23,875)	\$ 2,050,577

(Internal transactions are eliminated based on Generally Accepted Accounting Principles)

PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

NOTE 12 - SEGMENTS FOR THE YEAR ENDED DECEMBER 31, 2012

SCHEDULE OF REVENUES, EXPENSES AND CHANGES IN NET POSITION

(AMOUNTS IN THOUSANDS)	Electric System	Priest Rapids Project	Other	Total
OPERATING REVENUES	\$ 210,899	\$ 135,338	\$ (82,985)	\$ 263,252
OPERATING EXPENSES				
Depreciation and amortization	28,536	19,321	-	47,857
Other operating expenses	150,820	60,575	(82,985)	128,410
Total operating expenses	179,356	79,896	(82,985)	176,267
NET OPERATING INCOME	31,543	55,442	-	86,985
OTHER REVENUES (EXPENSES)				
Interest and other income	1,274	2,203	-	3,477
Interest on revenue bonds and other, net of capitalized interest of \$2,178	(6,792)	(44,572)	-	(51,364)
Federal rebates on revenue bonds	-	7,809	-	7,809
Amortization of debt expense, discount, and premium	3,059	(658)	-	2,401
Total other revenues (expenses)	(2,459)	(35,218)	-	(37,677)
CONTRIBUTIONS IN AID OF CONSTRUCTION	3,848	-	-	3,848
CHANGE IN NET POSITION	32,932	20,224	-	53,156
NET POSITION				
Beginning of year	535,551	203,686	-	739,237
End of year	\$ 568,483	\$ 223,910	\$ -	\$ 792,393

(Internal transactions are eliminated based on Generally Accepted Accounting Principles)

PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

NOTE 12 - SEGMENTS FOR THE YEAR ENDED DECEMBER 31, 2012

CONDENSED SCHEDULE OF CASH FLOWS

(AMOUNTS IN THOUSANDS)	Electric System	Priest Rapids Project	Other	Total
Net cash provided by (used in) operating activities	\$ 57,982	\$ 78,460	\$ (2,996)	\$ 133,446
Net cash used in capital and related financing activities	(52,827)	(113,272)	(7,016)	(173,115)
Net cash provided by investing activities	857	37,847	8,524	47,228
NET INCREASE (DECREASE) IN CASH	<u>\$ 6,012</u>	<u>\$ 3,035</u>	<u>\$ (1,488)</u>	<u>\$ 7,559</u>
CASH AT END OF YEAR	\$ 13,732	\$ 15,334	\$ (3,883)	\$ 25,183
CASH AT BEGINNING OF YEAR	7,721	12,298	(2,395)	17,624
NET INCREASE (DECREASE) IN CASH	<u>\$ 6,011</u>	<u>\$ 3,036</u>	<u>\$ (1,488)</u>	<u>\$ 7,559</u>

(Internal transactions are eliminated based on Generally Accepted Accounting Principles)

PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

NOTE 12 - SEGMENTS DECEMBER 31, 2011

CONDENSED STATEMENT OF NET POSITION

(AMOUNTS IN THOUSANDS)	Electric System	Priest Rapids Project	Other	Total
ASSETS				
Total current assets	\$ 155,655	\$ 97,999	\$ (33,189)	\$ 220,465
Net utility plant	474,880	933,183	-	1,408,063
Noncurrent	125,587	226,357	-	351,944
TOTAL ASSETS	\$ 756,122	\$ 1,257,539	\$ (33,189)	\$ 1,980,472
LIABILITIES				
Current	\$ 47,110	\$ 114,431	\$ (33,189)	\$ 128,352
Noncurrent	173,461	939,422	-	1,112,883
TOTAL LIABILITIES	220,571	1,053,853	(33,189)	1,241,235
NET POSITION				
Invested in capital assets, net of related debt	389,005	142,491	-	531,496
Restricted	17,401	57,468	-	74,869
Unrestricted	129,145	3,727	-	132,872
TOTAL NET POSITION	535,551	203,686	-	739,237
TOTAL LIABILITIES AND NET POSITION	\$ 756,122	\$ 1,257,539	\$ (33,189)	\$ 1,980,472

(Internal transactions are eliminated based on Generally Accepted Accounting Principles)

PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

NOTE 12 - SEGMENTS DECEMBER 31, 2011

SCHEDULE OF REVENUES, EXPENSES AND CHANGES IN NET POSITION

(AMOUNTS IN THOUSANDS)	Electric System	Priest Rapids Project	Other	Total
OPERATING REVENUES	\$ 240,060	\$ 140,183	\$ (87,178)	\$ 293,065
OPERATING EXPENSES				
Depreciation and amortization	28,178	17,061	-	45,239
Other operating expenses	182,923	63,624	(87,178)	159,369
Total operating expenses	211,101	80,685	(87,178)	204,608
NET OPERATING INCOME	28,959	59,498	-	88,457
OTHER REVENUES (EXPENSES)				
Interest and other income	949	3,060	-	4,009
Interest on revenue bonds and other, net of capitalized interest of \$2,780	(6,170)	(44,603)	-	(50,773)
Federal rebates on revenue bonds	-	7,123	-	7,123
Amortization of debt expense, discount, and premium	932	(734)	-	198
Total other revenues (expenses)	(4,289)	(35,154)	-	(39,443)
CONTRIBUTIONS IN AID OF CONSTRUCTION	8,660	-	-	8,660
CHANGE IN NET POSITION	33,330	24,344	-	57,674
NET POSITION				
Beginning of year	502,221	179,342	-	681,563
End of year	\$ 535,551	\$ 203,686	\$ -	\$ 739,237

(Internal transactions are eliminated based on Generally Accepted Accounting Principles)

PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

NOTE 12 - SEGMENTS DECEMBER 31, 2011

CONDENSED SCHEDULE OF CASH FLOWS

(AMOUNTS IN THOUSANDS)	Electric System	Priest Rapids Project	Other	Total
Net cash provided by operating activities	\$ 46,380	\$ 92,104	\$ 1,384	\$ 139,868
Net cash (used in) provided by capital and related financing activities	20,831	(164,916)	3,552	(140,533)
Net cash provided by (used in) investing activities	(73,500)	74,513	(2,793)	(1,780)
NET (DECREASE) INCREASE IN CASH	<u>\$ (6,289)</u>	<u>\$ 1,701</u>	<u>\$ 2,143</u>	<u>\$ (2,445)</u>
CASH AT END OF YEAR	\$ 7,721	\$ 12,298	\$ (2,395)	\$ 17,624
CASH AT BEGINNING OF YEAR	14,010	10,597	(4,538)	20,069
NET (DECREASE) INCREASE IN CASH	<u>\$ (6,289)</u>	<u>\$ 1,701</u>	<u>\$ 2,143</u>	<u>\$ (2,445)</u>

(Internal transactions are eliminated based on Generally Accepted Accounting Principles)

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APPENDIX C

PROPOSED FORM OF OPINION OF BOND COUNSEL

Public Utility District No. 2
of Grant County, Washington

Re: Public Utility District No. 2 of Grant County, Washington
Electric System Revenue Refunding Bonds, Series 2013-J – \$67,625,000

Ladies and Gentlemen:

We have served as bond counsel to Public Utility District No. 2 of Grant County, Washington (the “District”), and have examined a certified transcript of the proceedings taken in the matter of the issuance by the District of its Electric System Revenue Refunding Bonds, Series 2013-J, in the aggregate principal amount of \$67,625,000 (the “Bonds”), and in that capacity have examined such law and such certified proceedings and other documents as we have deemed necessary to render this opinion. As to matters of fact material to this opinion, we have relied upon representations contained in the certified proceedings and other certifications of public officials furnished to us, without undertaking to verify the same by independent investigation.

The Bonds are issued by the District pursuant to Resolution No. 8682 of the District’s Board of Commissioners (the “Bond Resolution”) to refund certain Electric System bonds, to fund a portion of the Reserve Fund and to pay costs of issuance of the Bonds.

Reference is made to the Bonds and the Bond Resolution for the definitions of capitalized terms used and not otherwise defined herein.

We have not been engaged nor have we undertaken to review the accuracy, completeness or sufficiency of the official statement or other offering material related to the Bonds (except to the extent, if any, stated in the official statement). We express no opinion relating to the undertaking by the District to provide ongoing disclosure pursuant to SEC Rule 15c2-12.

Under the Internal Revenue Code of 1986, as amended (the “Code”), the District is required to comply with certain requirements after the date of issuance of the Bonds in order to maintain the exclusion of the interest on the Bonds from gross income for federal income tax purposes, including, without limitation, requirements concerning the qualified use of Bond proceeds and the facilities financed or refinanced with Bond proceeds, limitations on investing gross proceeds of the Bonds in higher yielding investments in certain circumstances and the arbitrage rebate requirement to the extent applicable to the Bonds. The District has covenanted in the Bond Resolution to comply with those requirements, but if the District fails to comply with those requirements, interest on the Bonds could become taxable retroactive to the date of issuance of the Bonds. We have not undertaken and do not undertake to monitor the District’s compliance with such requirements.

Based upon the foregoing, as of the date of initial delivery of the Bonds to the purchasers thereof and full payment therefor, it is our opinion that under existing law:

1. The District has the right and power under Title 54 of the Revised Code of Washington (the “Act”) to adopt the Bond Resolution. The Bond Resolution has been duly and lawfully adopted by the District, is in full force and effect, is valid and binding upon the District and is enforceable in accordance with its terms.

2. The Bond Resolution creates the valid pledges under the Act which it purports to create of (i) the proceeds of the sale of the Bonds to the extent held in the funds established by the Bond Resolution, (ii) the Gross Revenue, subject to prior application to pay Operating Expenses (as such terms are defined in the Bond Resolution),

and (iii) the money and investments, if any, credited to the Revenue Fund, the Bond Fund, the Construction Fund and the Reserve and Contingency Fund, subject only to the terms and conditions set forth in the Bond Resolution.

3. The District is duly authorized and entitled to issue the Bonds, and the Bonds have been duly and validly authorized and issued by the District in accordance with the laws of the State of Washington, including the Act. The Bonds constitute the valid and binding obligations of the District as provided in the Bond Resolution, are enforceable in accordance with their terms and the terms of the Bond Resolution and are entitled to the benefits of the Act and the Bond Resolution. The Bonds are special limited obligations of the District and neither the State of Washington nor any political subdivision thereof, other than the District, is obligated to pay the principal of and interest on the Bonds, except to the extent that the enforcement of the rights and remedies of such owner of the Bonds may be limited by laws relating to bankruptcy, insolvency, moratorium, reorganization or other similar laws of general application affecting the rights of creditors, by the application of equitable principles and the exercise of judicial discretion.

4. Assuming compliance by the District after the date of issuance of the Bonds with applicable requirements of the Code, the interest on the Bonds is excluded from gross income for federal income tax purposes and is not an item of tax preference for purposes of the alternative minimum tax applicable to individuals; however, while interest on the Bonds also is not an item of tax preference for purposes of the alternative minimum tax applicable to corporations, interest on the Bonds received by corporations is to be taken into account in the computation of adjusted current earnings for purposes of the alternative minimum tax applicable to corporations, interest on the Bonds received by certain S corporations may be subject to tax, and interest on the Bonds received by foreign corporations with United States branches may be subject to a foreign branch profits tax. We express no opinion regarding any other federal tax consequences of receipt of interest on the Bonds.

This opinion is given as of the date hereof, and we assume no obligation to revise or supplement this opinion to reflect any facts or circumstances that may hereafter come to our attention, or any changes in law that may hereafter occur.

We bring to your attention the fact that the foregoing opinions are expressions of our professional judgment on the matters expressly addressed and do not constitute guarantees of result.

Respectfully submitted,

APPENDIX D

BOOK-ENTRY SYSTEM

The following information has been provided by the Depository Trust Company, New York, New York (“DTC”). The District makes no representation regarding the accuracy or completeness thereof. Beneficial Owners (as hereinafter defined) should therefore confirm the following with DTC or the Participants (as hereinafter defined).

DTC will act as securities depository for the Bonds. The Bonds will be issued as fully-registered in the name of Cede & Co. (DTC’s partnership nominee) or such other name as may be requested by an authorized representative of DTC. One fully-registered Bond certificate will be issued for each maturity of the Bonds in the principal amount of such maturity and will be deposited with DTC.

DTC, the world’s largest depository, is a limited-purpose trust company organized under the New York Banking Law, a “banking organization” within the meaning of the New York Banking Law, a member of the Federal Reserve System, a “clearing corporation” within the meaning of the New York Uniform Commercial Code, and a “clearing agency” registered pursuant to the provisions of Section 17A of the Securities Exchange Act of 1934. DTC holds and provides asset servicing for over 3.5 million issues of U.S. and non-U.S. equity issues, corporate and municipal debt issues, and money market instruments from over 100 countries that DTC’s participants (“Direct Participants”) deposit with DTC. DTC also facilitates the post-trade settlement among Direct Participants of sales and other securities transactions in deposited securities through electronic computerized book-entry transfers and pledges between Direct Participants’ accounts. This eliminates the need for physical movement of securities certificates. Direct Participants include both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, clearing corporations, and certain other organizations. DTC is a wholly-owned subsidiary of The Depository Trust & Clearing Corporation (“DTCC”). DTCC is the holding company for DTC, National Securities Clearing Corporation and Fixed Income Clearing Corporation, all of which are registered clearing agencies. DTCC is owned by the users of its regulated subsidiaries. Access to the DTC system is also available to others such as both U.S. and non-U.S. securities brokers and dealers, banks, and trust companies, and clearing corporations that clear through or maintain a custodial relationship with a Direct Participant, either directly or indirectly (“Indirect Participants”). DTC has Standard & Poor’s rating of AA+. The DTC Rules applicable to its Participants are on file with the Securities and Exchange Commission. More information about DTC can be found at www.dtcc.com.

Purchases of the Bonds under the DTC system, in denominations of \$5,000 or any integral multiple thereof, must be made by or through Direct Participants, which will receive a credit for the Bonds on DTC’s records. The ownership interest of each actual purchaser of each Bond (“Beneficial Owner”) is in turn to be recorded on the Direct and Indirect Participants’ records. Beneficial Owners will not receive written confirmation from DTC of their purchase. Beneficial Owners are, however, expected to receive written confirmations providing details of the transaction, as well as periodic statements of their holdings, from the Direct or Indirect Participant through which the Beneficial Owner entered into the transaction. Transfers of ownership interests in the Bonds are to be accomplished by entries made on the books of Direct and Indirect Participants acting on behalf of Beneficial Owners. Beneficial Owners will not receive certificates representing their ownership interests in the Bonds, except in the event that use of the book-entry entry system for the Bonds is discontinued.

To facilitate subsequent transfers, all Bonds deposited by Participants with DTC are registered in the name of DTC’s partnership nominee, Cede & Co. or such other name as may be requested by an authorized representative of DTC. The deposit of Bonds with DTC and their registration in the name of Cede & Co. or such other nominee do not effect any change in beneficial ownership. DTC has no knowledge of the actual Beneficial Owners of the Bonds; DTC’s records reflect only the identity of the Direct Participants to whose accounts such Bonds are credited, which may or may not be the Beneficial Owners. The Direct and Indirect Participants will remain responsible for keeping account of their holdings on behalf of their customers.

When notices are given, they shall be sent by the Bond Registrar to DTC only. Conveyance of notices and other communications by DTC to Direct Participants, by Direct Participants to Indirect Participants, and by Direct Participants and Indirect Participants to Beneficial Owners will be governed by arrangements among them, subject to any statutory or regulatory requirements as may be in effect from time to time.

Redemption notices shall be sent to DTC. If less than all of the Bonds are being redeemed, DTC's practice is to determine by lot the amount of the interest of each Direct Participant in such issue to be redeemed.

Neither DTC nor Cede & Co. (nor any other DTC nominee) will consent or vote with respect to the Bonds unless authorized by a Direct Participant in accordance with DTC's MMI Procedures. Under its usual procedures, DTC mails an Omnibus Proxy to the District as soon as possible after the record date. The Omnibus Proxy assigns Cede & Co.'s consenting or voting rights to those Direct Participants to whose accounts Bonds are credited on the record date (identified in a listing attached to the Omnibus Proxy).

Redemption proceeds, distributions, and dividend payments on the Bonds will be made to Cede & Co. or such other nominee as may be requested by an authorized representative of DTC. DTC's practice is to credit Direct Participants' accounts upon DTC's receipt of funds and corresponding detail information from the District or the Bond Registrar, on payable date in accordance with their respective holdings shown on DTC's records. Payments by Participants to Beneficial Owners will be governed by standing instructions and customary practices, as is the case with securities held for the accounts of customers in bearer form or registered in "street name," and will be the responsibility of such Participant and not of DTC, the Bond Registrar, or the District, subject to any statutory or regulatory requirements as may be in effect from time to time. Payment of redemption proceeds, distributions, and dividend payments to Cede & Co. (or any other nominee as may be requested by an authorized representative of DTC) is the responsibility of the District or the Bond Registrar, disbursement of such payments to Direct Participants will be the responsibility of DTC, and disbursement of such payments to the Beneficial Owners will be the responsibility of Direct and Indirect Participants.

DTC may discontinue providing its services as securities depository with respect to the Bonds at any time by giving reasonable notice to the District and the Bond Registrar. Under such circumstances, in the event that a successor securities depository is not obtained, Bond certificates are required to be printed and delivered.

The District may decide to discontinue use of the system of the book-entry transfers through DTC (or a successor securities depository). In that event, Bond certificates will be printed and delivered to DTC.

With respect to Bonds registered on the Bond Register in the name of Cede & Co., as nominee of DTC, the District and the Bond Registrar shall have no responsibility or obligation to any Participant or to any person on behalf of whom a Participant holds an interest in the Bonds with respect to (i) the accuracy of the records of DTC, Cede & Co. or any Participant with respect to any ownership interest in the Bonds; (ii) the delivery to any Participant or any other person, other than a bondowner as shown on the Bond Register, of any notice with respect to the Bonds, including any notice of redemption; (iii) the payment to any Participant or any other person, other than a bondowner as shown on the Bond Register, of any amount with respect to principal of, premium, if any, or interest on the Bonds; (iv) the selection by DTC or any Participant of any person to receive payment in the event of a partial redemption of the Bonds; (v) any consent given action taken by DTC as registered owner; or (vi) any other matter. The District and the Bond Registrar may treat and consider Cede & Co., in whose name each Bond is registered on the Bond Register, as the holder and absolute owner of such Bond for the purpose of payment of principal and interest with respect to such Bond, for the purpose of giving notices of redemption and other matters with respect to such Bond, for the purpose of registering transfers with respect to such Bond, and for all other purposes whatsoever. For the purposes of this Official Statement, the term "Beneficial Owner" shall include the person for whom the Participant acquires an interest in the Bonds.

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