

*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 2014A Bonds and 2014B Bonds, interest on the 2014A Bonds and 2014B Bonds (except any 2014B Bond for any period during which it is held by a “substantial user” of the Priest Rapids Project or by a “related person” within the meaning of Section 147(a) of the Code) is excluded from gross income for federal income tax purposes. Interest on the 2014A Bonds is not an item of tax preference under the Code and is not subject to the federal alternative minimum tax applicable to individuals. However, interest on the 2014A 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. However, interest on the 2014B Bonds received by individuals and corporations will constitute an item of tax preference under the Code and may be subject to the federal alternative minimum tax. In addition, interest on the 2014A Bonds and 2014B Bonds received by certain S corporations may be subject to tax, and interest on the 2014A Bonds and 2014B Bonds received by foreign corporations with United States branches may be subject to a foreign branch profits tax. Receipt of interest on the 2014A Bonds and 2014B Bonds may have other federal tax consequences for certain taxpayers. See “TAX MATTERS—2014A Bonds” and “—2014B Bonds.”*



**PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON  
PRIEST RAPIDS HYDROELECTRIC PROJECT REVENUE AND REFUNDING BONDS, 2014**

**SERIES A –  
\$150,725,000**

**SERIES B (AMT) –  
\$53,440,000**

**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, 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, 2015, 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 E—“BOOK-ENTRY SYSTEM.” Certain of the Bonds are subject to redemption prior to maturity. See “DESCRIPTION OF THE BONDS.”

The Bonds are being issued by the District to finance improvements to the Priest Rapids Project and to refund certain outstanding bonds of the Priest Rapids Project. See “PURPOSE AND APPLICATION OF BOND PROCEEDS.” The Bonds are payable from and secured by a lien and charge on the Gross Revenues of the Priest Rapids Project, after payment of Operating Expenses, and on certain other money, funds and accounts of the Priest Rapids Project. The Bonds are issued on a parity with the Outstanding Parity Bonds, currently outstanding in the principal amount of \$971,705,000 (of which \$119,840,000 will be refunded with proceeds of the Bonds), and any Future Parity Bonds. The District has covenanted not to issue any bonds with a lien on Gross Revenues senior to the lien securing the Parity Bonds. See “SECURITY FOR THE PARITY BONDS.” Simultaneously with the issuance of the Bonds, the District expects to issue a Priest Rapids Hydroelectric Project Junior Lien Revenue Bond, 2014 (Taxable), in the principal amount of \$45,500,000 that will be junior to the lien on the Net Revenues of the Priest Rapids Project securing the Parity Bonds. In addition, the District expects to issue approximately \$50,000,000 of Electric System Revenue Bonds, Series 2014-K on or about November 20, 2014.

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 IS PLEDGED TO THE PAYMENT THEREOF.

The maturity schedules for the Bonds are 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 November 18, 2014, through the facilities of DTC in New York, New York, by Fast Automated Securities Transfer.*

**Citigroup**

**J.P. Morgan**

**Morgan Stanley**

**RBC Capital Markets**

Dated: October 21, 2014

**MATURITY SCHEDULES, INTEREST RATES, YIELDS AND CUSIP NUMBERS**

**\$150,725,000**

**Priest Rapids Hydroelectric Project Revenue and Refunding Bonds, 2014 Series A**

<b>Maturity (January 1)</b>	<b>Amount</b>	<b>Interest Rate</b>	<b>Initial Reoffering Yield</b>	<b>CUSIP No.*</b>
2015	\$ 340,000	3.00%	0.20%	387883UH2
2016	2,570,000	3.00	0.28	387883UJ8
2017	4,880,000	3.00	0.52	387883UK5
2018	5,040,000	3.00	0.80	387883UL3
2019	4,275,000	5.00	1.07	387883UM1
2020	4,475,000	5.00	1.35	387883UN9
2021	4,710,000	5.00	1.61	387883UP4
2022	4,945,000	5.00	1.85	387883UQ2
2023	5,195,000	5.00	2.05	387883UR0
2024	3,935,000	5.00	2.17	387883US8
2025	4,125,000	5.00	2.32**	387883UT6
2026	4,335,000	5.00	2.46**	387883UU3
2027	4,560,000	5.00	2.58**	387883UV1
2028	4,780,000	5.00	2.68**	387883UW9
2029	5,015,000	5.00	2.73**	387883UX7
2030	7,635,000	5.00	2.79**	387883UY5
2031	7,180,000	5.00	2.86**	387883UZ2
2032	5,920,000	5.00	2.92**	387883VA6
2033	6,225,000	5.00	2.97**	387883VB4

\$35,160,000 4.00% Term Bond due January 1, 2039, initial reoffering yield of 3.59%\*\*; CUSIP No. 387883VC2\*

\$25,425,000 4.00% Term Bond due January 1, 2044, initial reoffering yield of 3.69%\*\*; CUSIP No. 387883VD0\*

**\$53,440,000**

**Priest Rapids Hydroelectric Project Revenue Refunding Bonds, 2014 Series B (AMT)**

<b>Maturity (January 1)</b>	<b>Amount</b>	<b>Interest Rate</b>	<b>Initial Reoffering Yield</b>	<b>CUSIP No.*</b>
2015	\$ 130,000	3.00%	0.25%	387883VE8
2016	1,315,000	3.00	0.34	387883VF5
2017	1,355,000	5.00	0.62	387883VG3
2018	1,425,000	5.00	1.02	387883VH1
2019	1,495,000	5.00	1.34	387883VJ7
2020	1,570,000	5.00	1.61	387883VK4
2021	1,650,000	5.00	1.91	387883VL2
2022	1,730,000	5.00	2.15	387883VM0
2023	1,820,000	5.00	2.35	387883VN8
2024	1,910,000	5.00	2.47	387883VP3
2025	2,005,000	5.00	2.62**	387883VQ1
2026	2,105,000	5.00	2.76**	387883VR9
2027	2,205,000	5.00	2.88**	387883VS7
2028	2,315,000	5.00	2.98**	387883VT5
2029	2,430,000	5.00	3.03**	387883VU2
2030	2,555,000	5.00	3.09**	387883VV0
2031	2,685,000	5.00	3.16**	387883VW8
2032	2,815,000	5.00	3.22**	387883VX6
2033	2,960,000	5.00	3.27**	387883VY4
2034	3,110,000	5.00	3.32**	387883VZ1

\$13,855,000 4.00% Term Bond due January 1, 2038, initial reoffering yield of 3.86%\*\*; CUSIP No. 387883WA5\*

\* The CUSIP data herein is provided by CUSIP Global Services, managed on behalf of the American Bankers Association by Standard & 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, 2024 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**  
**30 "C" Street S.W.**  
**Ephrata, Washington 98823**  
**(509) 754-0500**  
**www.gcpud.org\***

**Commissioners**

Bob Bernd.....	President
Dale Walker .....	Vice President
Thomas Flint.....	Secretary
Terry Brewer .....	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-Treasurer
Dawn Woodward.....	Director of Hydro
Brett Bergeson.....	Auditor

**Bond and Disclosure Counsel**

Foster Pepper PLLC  
Seattle, Washington

**Financial Advisor**

Public Financial Management, Inc.  
Los Angeles, California

**Paying Agent and Registrar**  
**(currently, the Fiscal Agent of the State of Washington)\*\***

The Bank of New York Mellon

**Bond Trustee\*\*\***

The Bank of New York Mellon Trust Company, N.A.

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\* 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.

\*\* U.S. Bank National Association is scheduled to become the Fiscal Agent of the State of Washington effective February 1, 2015.

\*\*\* Through December 31, 2014. As of January 1, 2015, the District will hold the various accounts and there will be no Trustee.

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**PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON**

**OFFICIAL STATEMENT**

**RELATING TO**

**\$150,725,000**

**PRIEST RAPIDS HYDROELECTRIC PROJECT REVENUE AND REFUNDING BONDS, 2014 SERIES A**

**AND**

**\$53,440,000**

**PRIEST RAPIDS HYDROELECTRIC PROJECT REVENUE REFUNDING BONDS,  
2014 SERIES B (AMT)**

**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” or “Grant County PUD”), the District’s Priest Rapids Hydroelectric Project (the “Priest Rapids Project”), which consists of the Priest Rapids Development and the Wanapum Development, certain of the purchasers of the output of the Priest Rapids Project other than the District (the “Power Purchasers”), the District’s electric transmission, distribution, telecommunications and generating system (the “Electric System”), and the District’s \$150,725,000 principal amount of Priest Rapids Hydroelectric Project Revenue and Refunding Bonds, 2014 Series A (the “2014A Bonds”), and \$53,440,000 principal amount of Priest Rapids Hydroelectric Project Revenue Refunding Bonds, 2014 Series B (AMT) (the “2014B Bonds,” and together with the 2014A Bonds, the “Bonds”). Capitalized terms used herein and not defined have the meanings ascribed thereto in APPENDIX A—“SUMMARY OF CERTAIN PROVISIONS OF THE BOND RESOLUTION.”

The Bonds are to be issued pursuant to Chapter 1 of the Laws of Washington, 1931, as amended and supplemented, constituting Title 54 of the Revised Code of Washington (the “Enabling Act”) and Chapters 39.46 and 39.53 of the Revised Code of Washington. The Bonds are authorized by Resolution No. 8747 of the District, adopted on October 14, 2014 (the “Bond Resolution”).

In 2010, the District consolidated the Priest Rapids Development and the Wanapum Development into one system called the Priest Rapids Project. See “SECURITY FOR THE PARITY BONDS—Pledge of Revenues; Consolidation of Developments.” The District has previously issued \$18,450,000 principal amount of its Priest Rapids Hydroelectric Development Second Series Revenue Bonds, 2003 Series Z (the “2003 Priest Rapids Bonds”), \$139,515,000 principal amount of its Priest Rapids Hydroelectric Development Revenue and Refunding Bonds, 2005 Series A, B and Z (the “2005 Priest Rapids Bonds”), \$66,610,000 principal amount of its Priest Rapids Hydroelectric Development Revenue and Refunding Bonds, 2006 Series A, B and Z (the “2006 Priest Rapids Bonds”), \$20,135,000 principal amount of its Wanapum Hydroelectric Development Second Series Revenue Bonds, 2003 Series Z (the “2003 Wanapum Bonds”), \$127,780,000 principal amount of its Wanapum Hydroelectric Development Revenue and Refunding Bonds, 2005 Series A, B and Z (the “2005 Wanapum Bonds”), \$186,430,000 principal amount of its Wanapum Hydroelectric Development Revenue and Refunding Bonds, 2006 Series A, B and Z (the “2006 Wanapum Bonds”), \$349,430,000 principal amount of its Priest Rapids Hydroelectric Project Revenue and Refunding Bonds, 2010 Series A, B, L, M and Z (the “2010 Priest Rapids Project Bonds”), \$127,620,000 principal amount of Priest Rapids Hydroelectric Project Revenue and Refunding Bonds, 2012 Series A, B, M and Z (the “2012 Priest Rapids Project Bonds”) and \$100,070,000 principal amount of Priest Rapids Hydroelectric Project Revenue Bonds, 2013 Series A and Z (the “2013 Priest Rapids Project Bonds”). The 2003 Priest Rapids Bonds, 2005 Priest Rapids Bonds, 2006 Priest Rapids Bonds, 2003 Wanapum Bonds, 2005 Wanapum Bonds, 2006 Wanapum Bonds, 2010 Priest Rapids Project Bonds, 2012 Priest Rapids Project Bonds and 2013 Priest Rapids Project Bonds are referred to as the “Outstanding Parity Bonds.” The Outstanding Parity Bonds, the Bonds and any other bonds hereafter issued on a parity with such bonds (“Future Parity Bonds”) are collectively referred to herein as the “Parity Bonds.” The Outstanding Parity Bonds are currently outstanding in the aggregate principal amount of

\$971,705,000, of which \$119,840,000 will be refunded with a portion of the proceeds of the Bonds. For a summary of currently Outstanding Parity Bonds, see Table 14.

The Parity Bonds are payable from and secured by a lien and charge on the Gross Revenues of the Priest Rapids Project, after payment of Operating Expenses, and on certain other money, funds and accounts of the Priest Rapids Project. See “SECURITY FOR THE PARITY BONDS.”

Simultaneously with the issuance of the Bonds, the District expects to issue a Priest Rapids Hydroelectric Project Junior Lien Revenue Bond, 2014 (Taxable) in the principal amount of \$45,500,000 (the “Junior Lien Bond”), which will be purchased by the District’s Electric System and be junior to the lien on the Net Revenues of the Priest Rapids Project securing the Parity Bonds.

The District expects to issue approximately \$50,000,000 of Electric System Revenue Bonds, Series 2014-K (the “Electric System 2014 Bonds”) on or about November 20, 2014.\*

## PURPOSE AND APPLICATION OF BOND PROCEEDS

### Purpose of the Bonds

The Bonds are being issued to finance capital improvements to the Priest Rapids Project, refund certain Outstanding Parity Bonds, fund the Reserve Account and pay all or a portion of the costs of issuance of the Bonds. The capital improvements to be financed with a portion of the 2014A Bonds and the Junior Lien Bond include: turbine/generator restoration, powerhouse improvements, improvements required by the FERC license, spillway improvements and other capital improvements. See “THE PRIEST RAPIDS PROJECT—Estimated Capital and Financing Requirements.”

### Refunding Plan

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

<b>Refunded Bonds</b>						
<b>Bonds</b>	<b>Maturity Dates</b>	<b>Interest Rates</b>	<b>Par Amounts</b>	<b>Call Dates</b>	<b>Call Price</b>	<b>CUSIP Numbers</b>
<i><b>Priest Rapids Hydroelectric Development Revenue and Refunding Bonds, Series 2005A (Not Subject to AMT)</b></i>						
Serials	01/01/2017	5.000%	\$ 2,395,000	01/01/2016	100%	387883HS3
	01/01/2018	5.000	2,510,000	01/01/2016	100	387883HT1
	01/01/2019	5.000	2,630,000	01/01/2016	100	387883HU8
	01/01/2020	5.000	2,755,000	01/01/2016	100	387883HV6
	01/01/2021	5.000	2,895,000	01/01/2016	100	387883HW4
	01/01/2022	5.000	3,045,000	01/01/2016	100	387883HX2
	01/01/2023	5.000	3,195,000	01/01/2016	100	387883HY0
	01/01/2024	5.000	1,730,000	01/01/2016	100	387883HZ7
	01/01/2025	5.000	1,810,000	01/01/2016	100	387883JA0
Term	01/01/2030	5.000	7,920,000	01/01/2016	100	387883JB8
Term	01/01/2030	4.500	2,580,000	01/01/2016	100	387883JC6
Term	01/01/2033	5.000	3,655,000	01/01/2016	100	387883JD4
Subtotal			\$37,120,000			



**Refunded Bonds**

<b>Bonds</b>	<b>Maturity Dates</b>	<b>Interest Rates</b>	<b>Par Amounts</b>	<b>Call Dates</b>	<b>Call Price</b>	<b>CUSIP Numbers</b>
<b><i>Wanapum Hydroelectric Development Revenue and Refunding Bonds, Series 2005A (Not Subject to AMT)</i></b>						
Serials	01/01/2016	3.800%	\$ 300,000	01/01/2015	100%	387892RK0
	01/01/2016	5.000	565,000	01/01/2015	100	387892RL8
	01/01/2017	4.000	640,000	01/01/2015	100	387892RM6
	01/01/2017	5.000	265,000	01/01/2015	100	387892RN4
	01/01/2018	5.000	960,000	01/01/2015	100	387892RP9
Term	01/01/2034	5.000	10,845,000	01/01/2015	100	387892RX2
Term	01/01/2038	5.000	9,325,000	01/01/2015	100	387892RY0
Subtotal			<u>\$22,900,000</u>			
<b><i>Wanapum Hydroelectric Development Revenue Bonds, Series 2005B (Subject to AMT)</i></b>						
Serials	01/01/2016	5.250%	\$ 1,435,000	01/01/2015	100%	387892SK9
	01/01/2017	5.250	1,510,000	01/01/2015	100	387892SL7
	01/01/2018	5.250	1,590,000	01/01/2015	100	387892SM5
	01/01/2019	5.250	1,675,000	01/01/2015	100	387892SN3
	01/01/2020	5.250	1,760,000	01/01/2015	100	387892SP8
	01/01/2021	5.250	1,855,000	01/01/2015	100	387892SQ6
	01/01/2022	5.250	1,950,000	01/01/2015	100	387892SR4
	01/01/2023	5.250	2,055,000	01/01/2015	100	387892SS2
	01/01/2024	5.250	2,160,000	01/01/2015	100	387892ST0
Term	01/01/2029	4.800	12,510,000	01/01/2015	100	387892SU7
Term	01/01/2034	4.700	15,790,000	01/01/2015	100	387892SV5
Term	01/01/2038	4.750	15,530,000	01/01/2015	100	387892SW3
Subtotal			<u>\$59,820,000</u>			
Total			<u>\$119,840,000</u>			

A portion of the net proceeds from the sale of the Bonds will be deposited in the 2014 Refunding Account (the "Refunding Account") and used to purchase direct, noncallable obligations of the United States of America ("Acquired Obligations") to be held by U.S. Bank National Association (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 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 redemption dates and to redeem and retire the Refunded Bonds on the respective redemption dates 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 The Arbitrage Group 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 or redemption date for the Refunded Bonds and to pay the principal and premium, if any, of the Refunded Bonds on the dates fixed for redemption. 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 and other funding sources are expected to be applied as follows:

### Sources and Uses

Sources	2014A Bonds	2014B Bonds	Total
Par Amount of Bonds	\$150,725,000	\$ 53,440,000	\$ 204,165,000
Original Issue Premium	17,456,364	6,378,194	23,834,558
Bond Fund Contribution	992,700	973,250	1,965,950
Transfer from Junior Lien Bond	0	3,362,408	3,362,408
Total	\$169,174,064	\$ 64,153,852	\$ 233,327,916

Uses	2014A Bonds	2014B Bonds	Total
Deposit to the Project Account	\$ 98,158,261	--	\$ 98,158,261
Deposit to the Refunding Account	63,289,227	\$ 61,278,413	124,567,640
Deposit to the Reserve Account	6,663,600	2,500,650	9,164,250
Underwriters' Discount and Costs of Issuance <sup>(1)</sup>	1,062,976	374,789	1,437,765
Total	\$169,174,064	\$ 64,153,852	\$233,327,916

(1) Includes underwriters' discount, bond counsel fees, financial advisor fees, refunding trustee fees, verification fees, rating fees, legal fees, Trustee and Registrar fees, and costs of posting and printing this Official Statement.

## DESCRIPTION OF THE BONDS

### General Terms

The 2014A Bonds will be issued in the aggregate principal amount of \$150,725,000 and will be dated the date of their delivery. The 2014A Bonds will bear interest at the rates per annum set forth on the inside cover page hereof, payable January 1, 2015, 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. Interest on the 2014A Bonds is not an item of tax preference for purposes of the federal alternative minimum tax imposed on individuals or corporations. See "TAX MATTERS—2014A Bonds."

The 2014B Bonds will be issued in the aggregate principal amount of \$53,440,000 and will be dated the date of their delivery. The 2014B Bonds will bear interest at the rates per annum set forth on the inside cover page hereof, payable January 1, 2015, 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 2014B Bonds are private activity bonds, and interest on the 2014B Bonds is a preference item for purposes of the federal alternative minimum tax imposed on individuals and corporations. See "TAX MATTERS—2014B Bonds."

The Bonds will be issuable in registered form, in the denomination of \$5,000 or any integral multiple thereof within a single series and 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 (the "State"), currently The Bank of New York Mellon, is the initial Registrar and Paying Agent for the Bonds. U.S. Bank National Association is scheduled to become the fiscal agent of the State effective February 1, 2015.

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. 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 Paying Agent 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 E—“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 of a series 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 series and 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 thereof at his expense), in the name of the transferee or transferees, a new Bond or Bonds of the same series, interest rate, aggregate principal amount 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 Bonds maturing on and after January 1, 2025, are subject to redemption prior to maturity, at the option of the District, in whole or in part on July 1, 2024, or any date thereafter, at 100% of the principal amount thereof, plus accrued interest, if any, to the date of redemption.

### **Mandatory Redemption**

The 2014A Bonds maturing on January 1 in the years 2039 and 2044 and the 2014B Bonds maturing on January 1 in the year 2038 (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 2014A Bonds and 2014B 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.

**2014A Bonds 2039 Term Bonds**

<u>Year</u>	<u>Sinking Fund Installment</u>
2034	\$5,655,000
2035	5,885,000
2036	6,120,000
2037	6,365,000
2038	6,620,000
2039*	4,515,000

\* Maturity.

**2014A Bonds 2044 Term Bonds**

<u>Year</u>	<u>Sinking Fund Installment</u>
2040	\$4,695,000
2041	4,885,000
2042	5,075,000
2043	5,280,000
2044**	5,490,000

**2014B Bonds 2038 Term Bonds**

<u>Year</u>	<u>Sinking Fund Installment</u>
2035	\$3,260,000
2036	3,395,000
2037	3,530,000
2038**	3,670,000

\*\* Final maturity.

Amounts used to purchase or redeem Bonds that are Term Bonds shall be credited against mandatory sinking fund installments by lot.

**Partial Redemption**

If less than all of the Bonds of a series are to be redeemed, the District may select the series and maturity or maturities or sinking funds within a maturity (if consistent with DTC operational procedures) to be redeemed. If less than all of the Bonds of a series 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, by lot, 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**

Notice of redemption is to be given at least 20 and not more than 60 days prior to the redemption date by first class mail to the registered owners of any Bonds to be redeemed at their last addresses appearing on the registration records of the Registrar. The District makes no assurances that DTC Participants or other nominees of the Beneficial Owners will distribute such redemption notices to the Beneficial Owners of the Bonds or that they will do so on a timely basis. Actual receipt of such notice by the registered owner of any Bond is not a condition precedent to the redemption of such Bond.

In the case of an optional redemption, the notice may state that the District retains the right to rescind the 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.

If, on the redemption date, money for the redemption of Bonds or portions thereof, together with interest to the redemption date, is held by the Paying Agent so as to be available therefor on such date and if notice of redemption has been given as aforesaid, then, from and after the redemption date, interest on the Bonds or portions thereof so called for redemption will cease to accrue and become payable.

### **Open Market Purchases**

The District has reserved the right to purchase Bonds 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 and if the escrow will be in place for more than 90 days, 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: (1) 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; (2) 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; (3) public housing bonds and project notes fully secured by contracts with the United States; and (4) 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; Consolidation of Developments**

In 2010, the District consolidated the Priest Rapids Development and the Wanapum Development into one system called the Priest Rapids Project. Prior to consolidation, the gross revenues of each development were accounted for separately, and each series of Outstanding Parity Bonds issued prior to 2010 was secured by the gross revenues of a single development. Pursuant to Resolution No. 8475, authorizing the issuance of the 2010 Priest Rapids Project Bonds, Resolution No. 8625, authorizing the issuance of the 2012 Priest Rapids Project Bonds, Resolution No. 8681, authorizing the issuance of the 2013 Priest Rapids Project Bonds, and the Bond Resolution, the Gross Revenues of the Priest Rapids Project have been pledged to pay and secure the payment of debt service on all Parity Bonds, and the operation and maintenance expenses, capital costs and other obligations of both Developments are payable from the Gross Revenues of the Priest Rapids Project.

The Parity Bonds are special limited obligations of the District payable from and secured solely by a lien and charge on (1) Gross Revenues, which include all income, revenues, receipts and profits received by the District through the ownership and operation of the Priest Rapids Project, together with the proceeds received by the District from the sale, lease or other disposition of any properties, rights or facilities of the Priest Rapids Project and certain

investment income, subject only to the prior payment of Operating Expenses, and (2) the money and assets, if any, credited to the Bond Fund, the Project Account and the Priest Rapids Project Repair, Renewal and Contingency Fund (the “RR&C Fund”), and the income therefrom. Gross Revenues include payments from the District’s Electric System as described under “Obligations of the Electric System.” The items described above are pledged as security for the payment of the principal of, premium, if any, and interest on all Parity Bonds in accordance with the provisions of the Bond Resolution. See APPENDIX A—“SUMMARY OF CERTAIN PROVISIONS OF THE BOND RESOLUTION” for a description of the security for the Parity Bonds and “Flow of Funds” below for a description of the priority of payments from the Gross Revenues of the Priest Rapids Project.

All Parity Bonds are equally and ratably payable and secured under the Bond Resolution without priority, except as otherwise expressly provided or permitted in the Bond Resolution and except as to municipal bond insurance and reserve account surety policies that may be obtained by the District to insure the repayment of one or more series or maturities within a series.

State law provides that the revenue obligations issued by a public utility district and interest thereon shall be a valid claim of the owner thereof only as against the special fund or funds provided for the payment of such obligations and the proportion or amount of the revenues pledged to such fund or funds, and that (1) such pledge of the revenues or other money or obligations shall be valid and binding from the time made, (2) the revenues or other money or obligations so pledged and thereafter received by a public utility district shall immediately be subject to the lien of such pledge without any physical delivery or further act, and (3) the lien of any such pledge shall be valid and binding as against any parties having claims of any kind in tort, contract or otherwise against a district irrespective of whether such parties have notice thereof. The Bonds are not secured by a mortgage, deed of trust, or security interest in the Priest Rapids Project or any of the physical plant and facilities thereof.

### **Obligations of the Electric System**

The following covenants in the Bond Resolution set forth the Electric System’s obligations to make payments to the Priest Rapids Project:

- 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 Parity 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 Electric System 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 is junior in rank to all other obligations of the Electric System. For a summary of outstanding debt of the District, see Table 14.

### **Flow of Funds**

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 Revenues. Earnings on money in the RR&C Fund and the Bond Fund may remain in such funds as provided by the Bond Resolution.

The amounts in the Revenue Fund may be used only for the following purposes and in the following order of priority:

- (1) to pay or provide for Operating Expenses;

(2) to make all payments required to be made into the Interest Account in the Bond Fund and to make any District Payments;

(3) to make all payments required to be made into the Principal and Bond Retirement Account in the Bond Fund;

(4) to make all payments required to be made into the Reserve Account in the Bond Fund and to make all payments required to be made pursuant to a reimbursement agreement(s) in connection with Qualified Insurance or a Qualified Letter of Credit;

(5) to make all payments required to be made into the RR&C Fund to the extent such amount is not on deposit (currently an amount in each month equal to .0125 of Annual Debt Service, to the extent not already funded); and

(6) to make all payments required to be made into any special fund or account created to pay or secure the payment of junior lien obligations of the Priest Rapids Project, including the Junior Lien Bond.

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 relating to the Priest Rapids Project.

If required by contract with the purchasers of power from the Priest Rapids Project, the District may rebate money in any fund except the Bond Fund to those purchasers. If the rebate is paid from the RR&C Fund, the District may again establish in the RR&C Fund an amount equal to the RR&C Fund Cap (currently \$12,000,000) from the proceeds of Parity Bonds, from Gross Revenues, or from any other sources. Any rebates may be paid to the Electric System on the same basis as to the other purchasers of power.

Under the Bond Resolution, the District is not permitted to issue additional bonds with a lien and charge upon Gross Revenues prior to the lien and charge of the Parity Bonds.

### **Limited Obligations**

The Parity Bonds do not in any manner or to any extent constitute general obligations of the District or of the State, or any political subdivision of the State, or a charge upon any general fund or upon any money or other property of the District or of the State, or of any political subdivision of the State, not specifically pledged thereto by the Bond Resolution.

### **Rate Covenants**

The District has covenanted in the Bond Resolution to establish, maintain and collect rates and charges in connection with the ownership and operation of the Priest Rapids Project that are fair and nondiscriminatory and adequate to provide Gross Revenues sufficient for the payment of the principal of and interest on all Outstanding Parity Bonds, all amounts which the District is obligated to set aside in the Bond Fund, the payment of all Operating Expenses of the Priest Rapids Project, and for the payment of any amounts that the District may now or hereafter become obligated to pay from Gross Revenues.

The District has also covenanted to establish, maintain and collect rates and charges in connection with the ownership and operation of the Priest Rapids Project sufficient to provide Net Revenues in any Fiscal Year in an amount that is at least equal to (i) 1.15 times the Annual Debt Service and debt service on the Junior Lien Bond in a Fiscal Year, plus (ii) any amounts required to be deposited into the Reserve Account in that Fiscal Year, less (iii) amounts transferred to the Bond Fund from the RR&C Fund in excess of the RR&C Fund Cap at the end of the preceding Fiscal Year, plus (iv) the amounts required to pay debt service on any junior lien obligations of the Priest Rapids Project.

Retail electric rates and charges of the District are fixed by the Commission, free from the jurisdiction and control of the Washington Utilities and Transportation Commission and, in the opinion of the District, free from the

jurisdiction and control of the Federal Energy Regulatory Commission (“FERC”). Wholesale electric rates and charges, however, are subject to certain regulations by FERC. See “THE PRIEST RAPIDS PROJECT—Regulatory Proceedings Affecting the Developments—Proceedings Before FERC.” The Priest Rapids Project is owned and operated by the District under a long-term license from FERC. See “THE PRIEST RAPIDS PROJECT—FERC License.” See “THE ELECTRIC SYSTEM—Rates” for a discussion of telecommunication rates.

### **Reserve Account**

A single Reserve Account in the Bond Fund secures all Parity Bonds. The Bond Resolution requires that there be deposited into the Reserve Account for each series of Parity Bonds an amount equal to the Reserve Account Requirement, calculated as of the date of issuance of such series. “Reserve Account Requirement” means, with respect to the Bonds and each issue of Outstanding Parity Bonds, the maximum amount of interest due in any Fiscal Year on such Parity Bonds computed as of the date of Closing of such issue, and with respect to an issue of Future Parity Bonds, the amount set forth in the resolution authorizing such Future Parity Bonds. However, so long as any 2005 Priest Rapids Bonds or 2005 Wanapum Bonds are insured by Financial Guaranty Insurance Company (“FGIC”) or any 2006 Priest Rapids Bonds or 2006 Wanapum Bonds are insured by MBIA Insurance Corporation, now known as National Public Finance Guaranty Corp. (“MBIA”), the Reserve Account Requirement with respect to any Future Parity Bonds secured by the Reserve Account shall be an amount equal to the maximum amount of interest due in any Fiscal Year on such Future Parity Bonds. The District will fund the Reserve Account Requirement for the Bonds on the date of issuance of the Bonds with \$9,164,250 in Bond proceeds. Upon the issuance of the Bonds, the Reserve Account Requirement for all Parity Bonds is \$67,085,270.

The Reserve Account Requirement may be funded either from Parity Bond proceeds or from Gross Revenues over a five-year period following the date of issuance, except that so long as the 2005 Priest Rapids Bonds or 2005 Wanapum Bonds are insured by FGIC or 2006 Priest Rapids Bonds or 2006 Wanapum Bonds are insured by MBIA, the Reserve Account Requirement must be fully funded on the date of issuance of any Parity Bonds. As an alternative, the District may fund all or a portion of the Reserve Account 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 Account Requirement through the deposit of a letter of credit or insurance policy.

To meet the Reserve Account Requirement for the Outstanding Parity Bonds, the District deposited in the Reserve Account \$18,625,900 of 2010 Priest Rapids Project Bond proceeds, \$4,812,073 of 2012 Priest Rapids Project Bond proceeds, \$4,954,784 of 2013 Priest Rapids Project Bond proceeds and obtained reserve account surety policies with MBIA, \$15,396,942 of which is available, with FGIC, \$13,356,821 of which is available, with Financial Security Assurance Inc., which is now known as Assured Guaranty Municipal Corp. (“FSA”), \$774,500 of which is available, and with Ambac Assurance Corporation (“Ambac”), \$502,750 of which is available. As of August 1, 2014, there was a balance of \$30,716,349 of cash, investments and accrued interest in the Reserve Account. Moody’s Investors Service (“Moody’s”) and Standard & Poor’s Ratings Services (“S&P”) currently rate MBIA “A3” and “AA-,” respectively and FSA “A2” and “AA,” respectively. Fitch Ratings (“Fitch”) has withdrawn its ratings for FSA and MBIA. Moody’s, S&P and Fitch have withdrawn their ratings for FGIC and Ambac. See “*Reserve Account Sureties for Outstanding Parity Bonds*” below. The resolutions authorizing the outstanding Parity Bonds do not require that the reserve surety policies be replaced when the insurers are downgraded.

The valuation of the amount on deposit in the Reserve Account is required to be made by the District on each December 31, and after certain withdrawals, 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. If the value of the Reserve Account is less than the Reserve Account Requirement, it must be replenished in six monthly payments.

The District has covenanted to make up any deficiency in the Interest Account and the Principal and Bond Retirement Account from the funds available in the Reserve Account. The District has covenanted to replenish such withdrawals from money in the Revenue Fund, the RR&C Fund or the Project Account, in not more than six equal monthly installments.



The owners of the 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 Account shall first be applied to remedy any deficiency in such account.

*Reserve Account Sureties for Outstanding Parity Bonds.* The surety bonds issued by Ambac, FSA, MBIA and FGIC provide that upon the later of (i) one day (three days for MBIA) after the receipt by the applicable surety of a demand for payment executed by the Paying Agent certifying that provision for the payment of principal of or interest on the Parity Bonds when due has not been made or (ii) the interest payment date specified in the demand for payment submitted to the applicable surety, the applicable surety will promptly deposit funds with the Paying Agent sufficient to enable the Paying Agent to make such payments due on the Parity Bonds, but in no event exceeding the policy limit of the surety bond so drawn on.

Pursuant to the terms of the surety bonds, the policy limits of each are automatically reduced to the extent of each payment made by the applicable surety under the terms of the surety bonds, and the District is required to reimburse the applicable surety for any draws under the surety bonds with interest at a market rate. Upon such reimbursement, the surety bonds are reinstated to the extent of each reimbursement up to but not exceeding the applicable policy limits. The reimbursement obligation of the District under the surety bonds is subordinate to the District's obligations with respect to the Parity Bonds.

In the event the amount on deposit in, or credited to, the Reserve Account exceeds the amount of the surety bonds, any draw on the surety bonds shall be made only after all the funds in the Reserve Account have been expended. In the event that the amount on deposit in, or credited to, the Reserve Account, in addition to the amount available under the surety bonds, includes amounts available under a letter of credit, insurance policy, surety bond or other such funding instrument, draws on the surety bonds and additional funding instruments shall be made on a pro rata basis to fund the insufficiency. The Bond Resolution provides that the Reserve Account shall be replenished by payments of principal of and interest on the surety bonds and on the additional funding instruments from first-available Gross Revenues on a pro rata basis. The surety bonds do not insure against nonpayment caused by the insolvency or negligence of the Paying Agent.

MBIA, FGIC, FSA and Ambac are subject to the informational requirements of the Exchange Act and in accordance therewith file reports, proxy statements and other information with the Securities and Exchange Commission ("SEC"). Certain SEC filings of MBIA are available on the company's website, [www.mbia.com](http://www.mbia.com) (which is not incorporated herein by this reference). Certain SEC filings of FGIC are available on the company's website, [www.fgic.com](http://www.fgic.com) (which is not incorporated herein by this reference). Certain SEC filings of FSA are available on the company's website, [www.assuredguaranty.com](http://www.assuredguaranty.com) (which is not incorporated herein by this reference). Certain SEC filings of Ambac are available on the company's website, [www.ambac.com](http://www.ambac.com) (which is not incorporated herein by this reference). Such reports, proxy statements and other information may also be inspected and copied at the SEC's Public Reference Room at 100 F Street, N.E., Washington, D.C. 20549. See APPENDIX A—"SUMMARY OF CERTAIN PROVISIONS OF THE BOND RESOLUTION—Bond Fund."

## **RR&C Fund**

The Bond Resolution provides that the Renewal, Replacement and Contingency Fund (the "RR&C Fund") must be maintained at a balance not to exceed the RR&C Fund Cap (currently \$12,000,000) or such greater or lesser amount as may be authorized by resolution of the Commission. Money in the RR&C Fund must be used to make up any deficiency in the Bond Fund and to the extent not required for such purpose may be applied to other specified purposes. See APPENDIX A—"SUMMARY OF CERTAIN PROVISIONS OF THE BOND RESOLUTION—RR&C Fund."

## **Future Parity Bonds**

Under the Bond Resolution, the District is not permitted to issue additional bonds with a lien and charge upon Gross Revenues prior to the lien and charge of the Parity Bonds.

Future Parity Bonds may be issued for any lawful purpose relating to the Priest Rapids Project upon the terms and conditions stated in the Bond Resolution. Such conditions include the delivery of an opinion of a Professional Utility Consultant to the effect that the issuance of such Future Parity Bonds and the expenditure of the proceeds thereof will not result in a violation of the District's rate covenants; provided, however, that such report is not required where contracts with the Electric System (which may include a resolution of the District with respect to such obligation of the Electric System) and/or other purchasers are in effect for a term at least as long as the term of the proposed Future Parity Bonds and require the Electric System and/or other purchasers to purchase 100% of the power from and to pay 100% of the costs of the Priest Rapids Project, including the cost of maintaining Net Revenues in the amounts required under the Bond Resolution. See "Rate Covenants" above and "Additional Parity Bonds" in APPENDIX A—"SUMMARY OF CERTAIN PROVISIONS OF THE BOND RESOLUTION."

The District expects to issue approximately \$65 million in Future Parity Bonds for the Priest Rapids Project in the next two years. See "THE PRIEST RAPIDS PROJECT—Estimated Capital and Funding Requirements." In addition, the District expects to issue Electric System Revenue Bonds in November 2014. In addition, if market conditions allow for the refunding of higher rate outstanding Parity Bonds, such refunding will be considered.

The District may issue bonds, notes, warrants or other obligations having a lien and charge against the Gross Revenues of the Priest Rapids Project junior to the Parity Bonds upon the terms and conditions stated in the Bond Resolution. Simultaneously with the issuance of the Bonds, the District expects to issue the Junior Lien Bond in the principal amount of \$45,500,000, which will be purchased by the District's Electric System junior to the lien on the Net Revenues of the Priest Rapids Project securing the Parity Bonds.

## **Derivative Products**

To the extent permitted by Washington State law, the District may enter into Derivative Products secured by a pledge of and lien on Gross Revenues on a parity with the Parity 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." The District does not have any Derivative Products issued in connection with the Outstanding Parity Bonds.

## **Contingent Payment Obligations**

The District has entered into, and may in the future enter into, contracts and agreements in the course of its business that include an obligation on the part of the District to make payments or post collateral contingent upon the occurrence or nonoccurrence of certain future events, including events that are beyond the direct control of the District. These agreements may include interest rate swaps and other similar agreements, agreements with respect to the delivery of electric energy or other energy, letter of credit agreements and other financial and energy hedging transactions. Such contingent payments or posting of collateral may be conditioned upon the future credit ratings of the District and/or other parties, maintenance by the District of specified financial ratios, future changes in energy prices, and other factors. The amount of any such payments or posting of collateral can be substantial. Some such payments may be characterized as Operating Expenses, and thus may be payable from Gross Revenues prior to the payment of debt service on the Parity Bonds. Other such payments may be payable on a parity with debt service on the Parity Bonds, including any "regularly scheduled payments" with respect to Derivative Products. The District has entered into the Western Systems Power Pool Agreements and contracts with the Bonneville Power Administration ("Bonneville") that include such contingent payment obligations. The agreements include

obligations on the part of the District to post collateral or a letter of credit contingent upon the occurrence or nonoccurrence of certain future events, such as future credit ratings below investment grade or defaults under power marketing contracts or indebtedness. See APPENDIX A—“SUMMARY OF CERTAIN PROVISIONS OF THE BOND RESOLUTION—Derivative Products” and “THE ELECTRIC SYSTEM—Power Supply Management and Power Marketing.”

### **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 Parity 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’ Trustee would be required to seek a separate judgment for each payment not made. Any such action for money damages would be subject to 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 District has never defaulted in the payment of principal, premium or interest on any of its bonds. See APPENDIX A—“SUMMARY OF CERTAIN PROVISIONS OF THE BOND RESOLUTION—Events Of Default, Bondowners’ Trustee, Remedies.”

## **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.

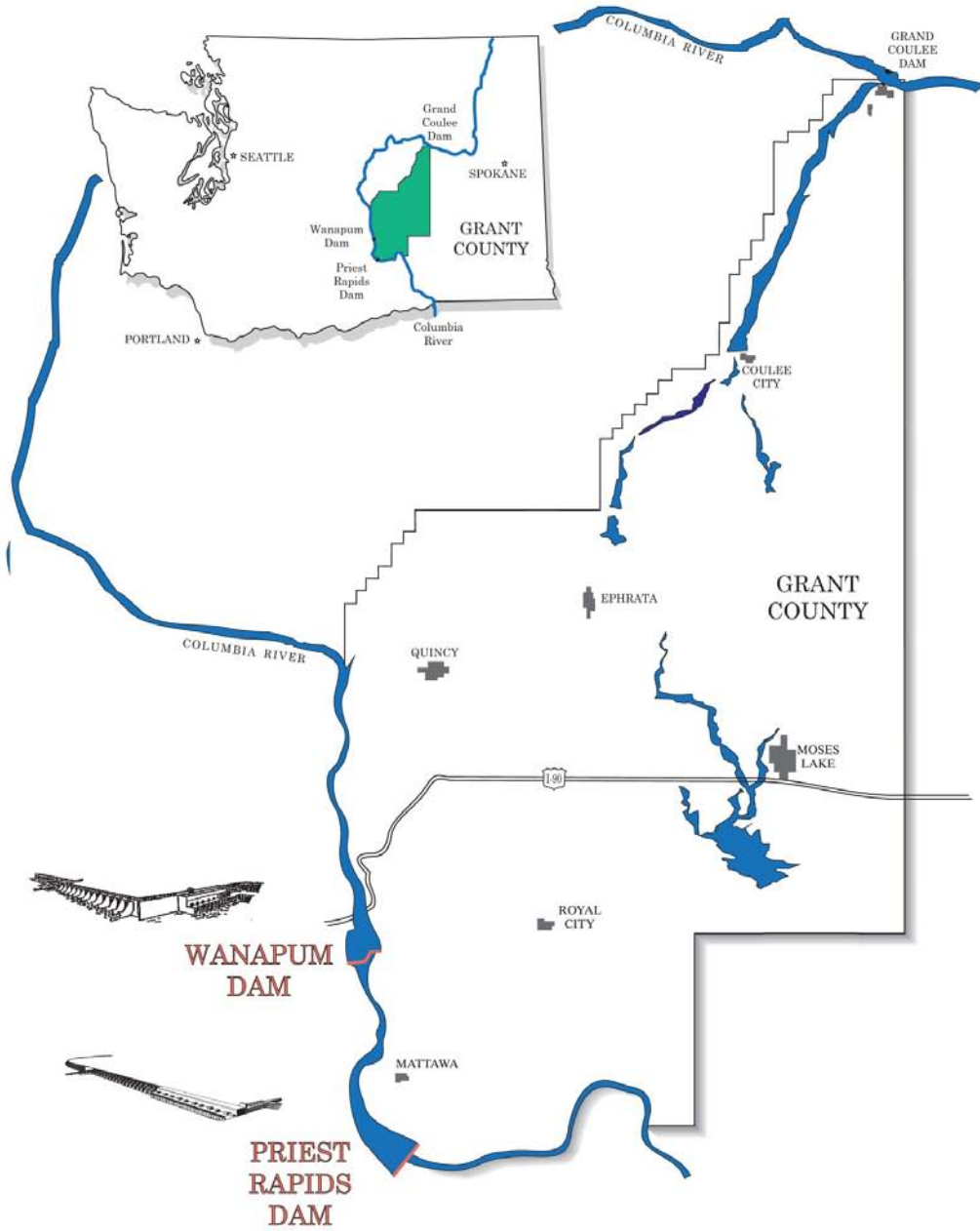
The District’s electric utility properties and operations consist of two operating systems, each of which is accounted for and financed separately. The systems are the Electric System and the Priest Rapids Project, which consists of the Priest Rapids Development and the Wanapum Development. The present combined total nameplate generating capacity of the Priest Rapids Project is approximately 2,067 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.

### Priest Rapids and Wanapum Developments



## 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)
Bob Bernd	President	2014
Dale Walker	Vice President	2016
Thomas Flint	Secretary	2016
Terry Brewer	Commissioner	2018
Larry Schaapman	Commissioner	2014

*Bob Bernd, 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, Vice President*, 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. He is a current Northwest Public Power Association Board Member. His family was involved in the development of the Columbia Basin Project.

*Thomas Flint, Secretary*, joined the Commission in 2001. He is a fifth generation farmer actively farming in Grant County. Commissioner Flint serves as a director on 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.

*Terry Brewer, Commissioner*, joined the Commission in 2007. He has over 30 years of experience in the electric utility industry. Commissioner Brewer served as Executive Director of the Grant County Economic Development Council for 15 years. He is a board member of Energy Northwest. Commissioner Brewer graduated from Indiana University with a business degree.

*Larry Schaapman, Commissioner*, was appointed to the Commission in 2012. 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, 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 30 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, natural resources and customer service 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 28 years of legal experience, including 22 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 has held numerous positions in the utility including 18 years in Customer Service management. She manages the support services and information technology functions.

*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. He holds a Bachelor of Science degree in Industrial Technology from the California Maritime Academy.

*Andrew Munro, Director of Customer Service*, joined the District in 2007. He has 22 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-Treasurer*, has been with the District since 2004. She manages the finance division, which includes the areas of accounting, treasury, strategic planning, and risk management. 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 in a Director capacity since 2000. She has extensive experience throughout the utility's operations and has served as the Director of Hydro since 2005. Ms. Woodward previously served as the Director of Customer Service, Support Services and Human Resources. Ms. Woodward has also represented the District in a wide variety of civic organizations throughout the County.

*Brett Bergeson, Auditor*, has been with the District since 2004. He was born and raised in Grant County and has nearly 20 years of experience with agricultural and financial businesses in the area. Prior to being appointed as Auditor in 2013, Mr. Bergeson served as the Manager of Strategic Planning, as the Energy Credit and Risk Analyst, in energy contract negotiations and as a Senior Accountant for the District. Mr. Bergeson holds a Bachelor of Arts degree in Finance from the University of Washington.

### **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 financial statements as of 2013 and 2012 and for each of the three years in the period ended December 31, 2013, included in this Official Statement, have been audited by PricewaterhouseCoopers LLP, independent accountants, as stated in their report appearing herein as Appendix C.

## District Employees

Following are the number of District employees by function as of August 28, 2014.

Function	Number of Regular Employees (Full Time)
Manager's Division	10
Power Management	38
HR/Safety	12
Accounting, Finance and Strategic Planning	19
Hydro Generation	227
Natural Resources	35
Support Services	97
Customer Service	177
Reliability and Compliance	4
Total	619

The District also has approximately 42 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 619 regular employees, as of August 28, 2014, 57% 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, 2017. 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, a 15-member board created by the Legislature in 1981, 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 based 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% (7.8% as of July 1, 2014) 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 (2005-2014) annualized return on the investment returns on the retirement funds was 8.35%.

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.

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**

	<u>Employer<sup>(1)</sup></u>	<u>Employee</u>
PERS Plan 1	9.21%	6.00%
PERS Plan 2	9.21	4.92
PERS Plan 3	9.21	Variable <sup>(2)</sup>

(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 July 2014, the PFC adopted contribution rate increases to be phased in over the next three biennia, beginning with the 2015-2017 biennium. For the 2015-2017 biennium beginning July 1, 2015, the PFC adopted employer rates of 11% for PERS Plans 1, 2 and 3 (in each case, net of administrative fees), and an employee rate of 6.12% for PERS Plan 2. The rates adopted by the PFC are subject to revision by the State Legislature.

In 2013, the District contributed approximately \$5,107,000 to the PERS system, on a covered payroll of \$61,205,547. 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, 2013 and 2012, attached hereto as APPENDIX C.

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. 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 actuarial valuation for Plan 1 as of June 30, 2012 showed a 69% funded ratio (unfunded liability of \$3.8 billion) while Plans 2 and 3 had valuation assets that exceed their accrued liability by \$2.3 billion (a 111% funded ratio). The State Actuary’s actuarial valuation for Plan 1 as of June 30, 2013 showed a 63% funded ratio (unfunded liability of \$4.831 billion) while Plans 2 and 3 had valuation assets that exceed their accrued liability by \$537 million (a 102% funded ratio). The decrease in the funded status and increase in the unfunded accrued actuarial liability primarily reflect changed demographic assumptions, including projected improvements in mortality rates, and the statutory requirement that the assumed rate of return be reduced to 7.8% from 7.9%. 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 AVA is calculated using a methodology which smoothes the effect of short-term volatility in the Market Value of Assets by deferring a portion of annual investment gains or losses over a period of up to eight years.

PERS Plans 2 and 3 are accounted for in the same pension trust fund and may legally be used to pay the defined benefits of any PERS Plan 2 or 3 members. 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 July 1, 2015 and certain minimum contribution rates that are to become effective on July 1, 2015 and remain in effect until the actuarial value of assets in PERS Plan 1 equals 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 was filed challenging this legislation, but the State Supreme Court recently upheld the constitutionality of the legislation. The information in this section has been obtained from the District's financial statements and information on the State Actuary's and State Department of Retirement System's websites.

### **Deferred Compensation Plans**

The District offers its employees a deferred compensation plan created under Internal Revenue Code Section 457(b), which permits employees to defer a portion of their compensation until future years. The plan is available to all active employees. The District has no liability for losses under the plan; it is completely funded with employee contributions.

The District also administers a 401(a) governmental money purchase plan and trust. Eligible employees can elect to either contribute to the 457 plan as discussed above, or the 401(a) defined contribution plan. The District's matching employer contributions (\$0.50 per \$1 of employee contributions) are deposited into the 401(a) plan, and is capped at 2% of straight-time employee wages for the pay period. The District made matching contributions of \$898,327 and \$842,426 in 2013 and 2012, respectively.

### **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. Under this program, the District pays a percentage of the medical premiums based upon years of service of the retiree, which cannot be more than the premium amount paid for active employees, and is effective until the retiree turns 65 years old. For the years ended December 31, 2013 and 2012, the District paid \$234,000 and \$286,000 in retiree subsidies. The District's net accrued other post-employment benefit obligation at the year ended December 31, 2013 was \$1,472,000.

As of December 31, 2013 and 2012, the District's actuarial accrued liability ("AAL") was \$4.1 million and \$4.2 million, respectively, all of which was unfunded. The AAL is amortized over a 30-year period and the increase in net OPEB obligation is accrued each year and split between the District's systems, based on current labor allocations. The covered payroll for the years ending 2013 and 2012 were \$54.4 million and \$52.5 million, respectively, and the ratio of unfunded obligation to the covered payroll was 7.6% and 8.0%, respectively. The District has no plans at this time to fund the obligation using an irrevocable trust. See Note 9 to the Audited Financial Statements for the Years Ended December 31, 2013 and 2012, attached hereto as APPENDIX C.

### **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 2013 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. The District's property insurance includes coverage for seismic risk, subject to a deductible of 2% of the total insured value of all affected locations.

### **Strategic Planning and Financial Policies**

The District operates under a strategic plan approved by the Commission in May 2011, which was updated in January 2013 and is 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, operations and maintenance, capital improvements, power supply, customer service, reliability and institutional matters such as 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), Revenue Fund balance of \$35 million and maintaining the Electric System Reserve and Contingency Fund balance at \$120 million. Financial parameters for the Priest Rapids Project include that outstanding debt shall be less than the net book value of the Priest Rapids Project 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. The District targets consolidated debt service coverage greater than or equal to 1.80 times and consolidated ratio of debt to net plant less than or equal to 60%. The District is targeting debt reduction at the Priest Rapids Project by equity financing from all or a portion of the Electric System's additional funds beyond the Revenue Fund and the Reserve and Contingency Fund goals. Any additional funds could also be used for retiring debt in the Electric System or the Priest Rapids Project.

### **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 United States Treasury bonds, notes, bills or other obligations of the United States government or agencies of the United States 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 United States 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, 2013.

#### **District's Investments**

United States Agencies	\$ 162,470,000
United States Treasuries	175,447,000
Money Market Account	55,467,000
Municipal Bonds	27,815,000
Repurchase Agreements	<u>6,000,000</u>
	<u>\$ 427,199,000</u>

For information relating to the District's investments, see Note 2 to the Audited Financial Statements for the Years Ended December 31, 2013 and 2012, attached hereto as Appendix C.

### **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.

### **Physical Security Efforts at the District**

Security is an integral part of District operations. The District has policies, procedures, and processes to ensure the physical protection of its employees, assets and facilities, with additional measures to protect facilities with critical cyber assets. A dedicated, centralized security department is in place to identify potential security risks, perform investigations of malicious activities on the premises, develop and oversee implementation of protection measures, and to maintain active communication with local, state and federal law enforcement.

In February 2014, a fracture was discovered on a Wanapum spillway monolith. See “THE PRIEST RAPIDS PROJECT—Wanapum Spillway Monolith Fracture.” To accommodate the repair work on the spillway, the reservoir was temporarily drawn down and the shoreline closed to the public. The District’s security department played a critical role in establishing prudent and cost-effective protection measures to secure the shoreline. Ensuring public safety and protecting cultural resources on the project shoreline is a condition of the District’s license to operate the Priest Rapids Project.

### **Technology Reliability and Cyber Security**

The District currently sustains compliance with all regulatory requirements around its information technology (“IT”) and Industrial Control System (“ICS”) resources. The District handles the constant challenge of mitigating threats related to both IT and ICS through a defense in depth approach. The architecture of its IT and ICS systems provide for both high availability and redundancy while mitigating both current threats and future threats.

As the North American Energy Reliability Corporation Critical Infrastructure Protection (“NERC CIP”) regulations outline the compliance requirements revolving around the District’s ICS systems, the District has dedicated resources and staff to building a culture of compliance through involvement and dedication to protecting its cyber assets. The cyber security staff dedicated to the reliability of the District’s IT and ICS systems are certified, trained and involved in the cyber security and electric industry organizations such as: the International Information Systems Security Certification Consortium, ISACA, the Northwest Public Power Association, the Large Public Power Council, the Western Interconnection Compliance Forum, and the Western Energy Coordination Council where information is shared and collaboration occurs to strengthen not only the District’s cyber security posture but also the western grid. In addition, cyber security guidelines such as the Information Technology Infrastructure Library, the Computer Objectives for Information and Related Technologies, the National Institute of Standards and Technology, and the International Organization of Standardization 27002 are consulted for best business practices. The District performs an annual vulnerability assessment to identify any outlying issues and gaps that can be mitigated as an effort to constantly grow its reliability posture.

## **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 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 1,111.4 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.

## **Wanapum Spillway Monolith Fracture**

On February 27, 2014, a horizontal fracture was discovered on the upstream side of Wanapum Dam's Spillway Monolith Number 4 ("Monolith No. 4"). The fracture ran the length of the 65-foot-wide monolith and was two inches tall at its widest point. A spillway monolith, and its associated pier, is the structure that supports the spillway gates. There are 13 spillway monoliths and 12 spillway gates at Wanapum Dam. Each monolith is independent of the others. Eleven of the monoliths are 65 feet wide and the two end monoliths are half monoliths. Wanapum Dam is 8,637 feet wide.

After consulting FERC, the District began to draw down the elevation of the Wanapum reservoir by 26 feet to reduce pressure on the monolith. A survey of the structure on March 4, 2014, showed that the fracture had closed and the monolith was stable. An examination of the upstream face of the dam found no other fractures similar to the fracture found on Monolith No. 4.

Following an 11-week investigation, it was determined that a mathematical error during the pre-construction design of Wanapum Dam was the primary contributing factor to the fracture. When engineers recalculated the original design formulas, they found that additional concrete or reinforced steel should have been included in the construction of Monolith No. 4 and all of the other 12 monoliths on Wanapum Dam. No other mathematical errors were discovered by the experts performing the investigation.

The District and its engineering consultants, MWH Americas, are working to repair the fracture in Monolith No. 4 and to anchor all 13 monoliths. Anchoring includes installing additional steel reinforcements from the top of the monoliths, through the concrete, and into bedrock below the dam.

It is anticipated that Wanapum Dam's reservoir will be restored to its normal operating range once the repair and stabilization work is complete, pending FERC approval. An independent Board of Consultants ("BOC") required by FERC is also reviewing the design of the repair and stabilization work. The BOC consists of three engineers with expertise in dam design. The BOC is independent of the District engineers and the external design engineers. Based on current data, repairs and additional capital work are expected to be complete by early 2015. After restoration of normal operations, the District anticipates some follow up seismic analysis may be required for spillway piers. This seismic analysis is in addition to other seismic analysis at the Priest Rapids Project. See "Priest Rapids Project Seismicity Study."

During the repair, Wanapum Dam continues to operate and the District continues to meet its obligations with regard to fish passage, flood-control, cultural resource protection, public safety, and electric generation. Recreational facilities and activities upstream of Wanapum Dam have been suspended or closed during the drawdown due to public safety and cultural resource concerns. The District has worked closely with irrigators to extend water

withdrawal infrastructure across District-owned lands during the drawdown. Recreational facilities and activities between Priest Rapids Dam and Wanapum Dam are operating as normal. At current levels, Wanapum Dam is capable of generating electricity at between 50% to 60% of capacity. The dam is able to accommodate river flows in coordination with other dams operating on the Columbia River.

The financial impact of the fracture has been manageable for the District. The District estimates the impact to net wholesale revenue for fiscal year 2014 is a reduction of approximately \$8 million versus budget. Gross incremental operations and maintenance expenditures for fiscal years 2014 and 2015 are estimated to be approximately \$19 million. Incremental capital requirements are driven almost exclusively by the structural improvement costs. Gross incremental capital costs due to the fracture and to correct the design error in the other monoliths are estimated to be \$42 million. A portion of the incremental capital expenditures are expected to be financed with the proceeds of the Priest Rapids Project 2014 Bonds. See “Estimated Capital and Financing Requirements.”

The District is aware of no pending or imminent legal claims arising from the Wanapum incident. Certain members of the public have suggested they should be compensated for lost recreational or business opportunities as a result of the drawdown. The legal theories that might be asserted against the District, as well as the nature or extent of any claims for damages, are presently unknown. The District does not believe claims for alleged damages, if any, will have a material effect on the District's ability to repay the Bonds.

### Energy Production

The following table shows the energy production for the Priest Rapids Project for the years 2009 to 2013. 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 1**  
**PRIEST RAPIDS PROJECT HISTORICAL ENERGY PRODUCTION<sup>(1)</sup>**

	2009	2010	2011	2012	2013
Priest Rapids Project					
Net Peaking Production (MW)	1,782	1,767	1,779	1,756	1,823
Net Energy Production (000's MWh) <sup>(2)</sup>	7,569	7,061	9,574	8,748	8,945
Annual Availability Factor <sup>(3)</sup>	90%	90%	90%	86%	86%
Plant Factor <sup>(4)</sup>	56%	53%	69%	64%	63%
Average Cost (\$/MWh) <sup>(5)</sup>	\$14.58	\$18.97	\$14.64	\$15.47	\$15.89
Bonneville Power PF Rate (\$/MWh) <sup>(6)</sup>	\$26.60	\$28.50	\$28.60	\$30.50	\$31.00

(1) During 2010, 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 82% of average in 2009, 81% of average in 2010, 126% of average in 2011, 120% of average in 2012 and 103% in 2013.

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

(5) For 2013, the average cost will not match the number reported of \$16.31 in the Management Discussion and Analysis section of the 2013 audited financial statements issued in April 28, 2014, due to a calculation oversight.

(6) Bonneville's published Priority Firm power rates.

Based on weather conditions and river run-off to date, it is expected that Columbia River run-off in 2014 will be approximately 104% of average. However, 2014 operations of the Priest Rapids Project have been affected by the lowering of the reservoir behind Wanapum Dam due to the fracture discovered on the Wanapum Monolith No. 4. See “Wanapum Spillway Monolith Fracture.”

## 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 with the District’s long-term power purchasers allow the District to meet the Electric System’s retail load requirements at the cost of 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 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 2**  
**PARTICIPATION IN COSTS OF PRIEST RAPIDS PROJECT—2013**

<u>Power Purchaser</u>	<u>Percent Share</u>	<u>Priest Rapids Project Nameplate Rating<sup>(1)</sup> (MW)</u>
PacifiCorp Electric Operations	9.85%	203.600
Portland General Electric	9.85	203.600
Puget Sound Energy, Inc.	5.68	117.406
Avista Corporation	4.32	89.294
Tacoma Power	2.23	46.094
Seattle City Light	2.21	45.681
Public Utility District No. 1 of Cowlitz County	1.30	26.871
Eugene Water and Electric Board	1.11	22.944
Other Power Purchasers <sup>(2)</sup>	2.59	53.535
The District’s Electric System	60.86	1,257.975
Total	<u>100.00%</u>	<u>2,067.000</u>

(1) Based on installed nameplate rating of 2,067.000 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—Obligations of the Electric System.”

- 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. The Product Sales Contract was amended to assign to certain 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—Obligations of the Electric System” 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. See “THE ELECTRIC SYSTEM—Potential Expansion and Enhanced Slice Sales Strategy” for information about the District’s possible expansion of its slice sales strategy.

### **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 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, 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 premium above the underlying energy value. The following table summarizes the auction winners from 2010 through 2014.

**Table 3**  
**REASONABLE PORTION AUCTION WINNERS**

<b>Period Covered</b>	<b>Auction Winner</b>	<b>Slice of Priest Rapids Project<sup>(1)</sup></b>	<b>Auction Price Priest Rapids Project</b>	<b>Total Reasonable Portion Revenues Generated<sup>(2)</sup></b>
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
12 mos. ending Dec. 2014	Morgan Stanley	10.14	30,311,100	–
12 mos. ending Dec. 2014	Powerex	10.14	30,688,504	90,280,618

(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 Estimated Unmet District Load (“EUDL”). On a planning basis, firm energy at the Priest Rapids Project equates to approximately 755 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, \$32,089,771 for 2009 and \$860,528 for 2014. In 2010, 2011, 2012 and 2013, the Electric System did not need to use Reasonable Portion Revenues because it did not have an EUDL. In 2014, the District has a EUDL of 3.1 aMW valued at \$860,528.



## Priest Rapids Project Output

The actual amounts of energy sold to the Power Purchasers for the fiscal years 2009 through 2013 are shown in the following table. During the years 2009 through 2013, the Priest Rapids Project delivered to the Power Purchasers and the District an average of 8,610,213 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 4**  
**PRIEST RAPIDS PROJECT HISTORICAL ENERGY SALES**  
**(MWh)<sup>(1)</sup>**

	2009	2010	2011	2012	2013
Gross Generation <sup>(2)</sup>	8,710,613	8,193,903	10,693,863	9,901,175	10,099,590
Plus: Pond Transfer <sup>(3)</sup>	(39,792)	41,451	101,146	(169,450)	(63,339)
Total Dissolved Gas Spill Return <sup>(4)</sup>	-	-	8,803	44,966	2,986
Less: Rock Island Encroachment <sup>(5)</sup>	(601,733)	(571,821)	(636,667)	(673,073)	(662,129)
Coordination Exchange <sup>(6)</sup>	1,866	695	(6,423)	3,895	2,386
Less: Canadian Entitlements <sup>(7)</sup>	(494,308)	(514,055)	(519,351)	(515,432)	(505,693)
Spill Past Unloaded Units <sup>(8)</sup>	(7,178)	(89,599)	(67,476)	155,457	71,610
Net Energy to Purchasers	7,569,468	7,060,574	9,573,895	8,747,538	8,945,411
Max. One-Hour Production (MW)	1,782	1,767	1,779	1,756	1,823
Plant Factor <sup>(9)</sup>	56%	53%	69%	64%	63%
Annual Availability Factor <sup>(10)</sup>	90%	90%	90%	86%	86%
Disposition of Net Energy					
District’s Electric System	3,651,136	4,036,382	5,715,363	5,337,812	5,520,331
PacifiCorp Electric Operations	732,664	629,567	170,171	194,845	128,302
Portland General Electric Co.	944,017	687,590	899,578	765,075	803,343
Puget Sound Energy, Inc.	374,752	78,153	55,137	79,076	72,986
City of Seattle	32,988	168,255	32,285	36,381	33,205
City of Tacoma	34,557	37,944	33,983	37,355	34,846
Avista Corporation	420,026	288,389	361,969	332,203	346,970
Cowlitz County PUD	156,109	129,527	151,008	21,358	19,326
Eugene Water & Electric Board	82,600	18,148	15,761	17,121	16,316
Other Power Purchasers <sup>(11)</sup>	1,140,619	986,619	2,138,640	1,926,312	1,969,786
Total	7,569,468	7,060,574	9,573,895	8,747,538	8,945,411

(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 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. The energy provided is not required to be sourced from the Priest Rapids Project.

(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 Development 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) 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.

For a discussion of Wanapum Development operations and availability since February 27, 2014, see “Wanapum Spillway Monolith Fracture.”

### **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 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. Negotiations have begun for a new agreement.

### **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 Power Purchasers through the Bonneville transmission system. The District has sufficient transmission facilities to deliver the entire District share of the Priest Rapids Project to the District’s loads.

### **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 United States 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. On December 13, 2013, the United States entity sent a final regional recommendation concerning the future of the Treaty to the United States Department of State. In general, the regional recommendation is to modernize the Treaty to more fairly reflect the distribution of operational benefits between the United States and Canada, to ensure that

flood risk management and other key river uses are preserved, and to address key ecosystem functions in a way that complements the significant investments made to protect fish and wildlife over the past three decades. The Department of State will use the final recommendation to begin a federal policy review process to determine whether to proceed with a Treaty modernization effort with Canada. The final recommendation states that the Pacific Northwest and the nation would benefit from modernization of the Treaty post-2024. Now that the final recommendation has been delivered to the United States Department of State, the United States government will formally take up the question of the Treaty. That process will be a federal interagency review under the general direction of the National Security Council on behalf of the President of the United States. As shown in Table 4, the Canadian entitlement creates an energy obligation for the project participants, effectively reducing the net energy available for the Priest Rapids Project participants, however, the obligation does not require sourcing from 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 United States 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 and Priest Rapids fish bypasses and spill to improve downstream passage of juvenile salmon and steelhead; 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 2014-2018 is estimated at \$70.7 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 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. Due to the fracture at the Wanapum spillway, seven boat launches and 10 recreational areas, including the Wanapum Heritage Center, have been closed since February 2014, but are expected to be re-opened by the end of 2014. See “Wanapum Spillway Monolith Fracture.” At the Priest Rapids Development, there are 12 developed and undeveloped recreation sites, including boat launches, campgrounds, and picnic areas. By the end of 2015, the District will have invested more than \$35 million in development of these recreation sites, 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 of this plan includes compliance activities associated with non-project uses of Priest Rapids 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 \$11.5 million is budgeted for 2014-2017 for cultural resource management. Response to the drawdown of the Wanapum Dam has cost an additional \$1 million to date with an estimated \$1 million budgeted for 2015 for cultural resources. See “Wanapum Spillway Monolith Fracture.”

### ***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 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 2012-2015 is \$21.2 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 District must receive written notice at least one year before physical delivery can occur. In addition, the Yakama Nation must satisfy three contingencies listed in the settlement agreement. To date, the contingencies have not been met and the District has not received any written notice requesting physical delivery. 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 \$2,266,513 for 2013, \$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 2019 is approximately \$2.0 million.

### **Regulatory Proceedings Affecting the Developments**

*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 United States 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 United States Bureau of Reclamation, and the United States Army Corps of Engineers have undertaken and are implementing certain measures to protect salmon. These measures 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, United States 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 United States Department of Interior, United States 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 United States 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, 2013 and December 31, 2012, equaled \$3.4 million and \$3.3 million, respectively. The District expects to contribute approximately \$13.2 million during the period 2014 through 2017.

*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 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 all ten Wanapum units with the most recent being placed in service in October 2013. 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.

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 fifth generator was placed in service in June 2014. The on-site construction is scheduled through April 2019. 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, 2013, the cost of replacing the remaining generators is estimated at \$90.8 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. Turbine modeling and hydraulic design has been completed and a contract to supply turbines was awarded to Voith Hydro in June 2014. The District continues working on the design and contracting process for generator and

governor equipment and expects to award contracts by early 2015. On-site work at the Priest Rapids Development is expected to begin in 2016 and be completed by 2026. In the 1990's, the main generating unit circuit breakers were replaced at the Wanapum and Priest Rapids Developments with SF6 gas breakers. 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, with work 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 volts and 13.2 kilovolts 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 and trunnion bearing replacements. 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 2015 and is expected to be completed in 2020. 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. There is a low probability that this remediation would be needed and, therefore, 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 2016.

## Estimated Capital and Financing Requirements

The District projects that the total cost of the capital program at the Priest Rapids Project during the period 2014 through 2018 will be approximately \$474.3 million, as shown in the table below, which will be financed by proceeds of prior, current, and future Parity Bonds. The Bonds and the Junior Lien Bond are expected to fund the remaining projected Priest Rapids Project capital improvements in 2014 and all of the projected Priest Rapids Project capital improvements in 2015. 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 5**  
**PRIEST RAPIDS PROJECT**  
**2014-2018 FORECAST CAPITAL PROGRAM EXPENDITURES**

Turbine/Generator Restoration	\$ 172,382,000
License Implementation	70,707,000
Powerhouse/Spillway Improvements <sup>(1)</sup>	210,757,000
Miscellaneous <sup>(2)</sup>	<u>20,454,000</u>
	<u>\$ 474,300,000</u>

(1) Includes \$42 million in capital improvements associated with the monoliths on the Wanapum Spillway. See "Wanapum Spillway Monolith Fracture." Expenditures classified as repairs are not included in these projections.

(2) 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 2009 through 2013. 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" and APPENDIX B—"SUMMARY OF CERTAIN PROVISIONS OF THE PRIEST RAPIDS PROJECT POWER SALES CONTRACTS."



**Table 6**  
**PRIEST RAPIDS PROJECT OPERATING RESULTS**  
**(\$000)**

	2009	2010	2011	2012	2013
Operating Revenues					
Sales of Power <sup>(1)</sup>	\$110,376	\$133,945	\$140,183	\$135,338	\$142,168
Interest and Other Income <sup>(2)</sup>	<u>3,484</u>	<u>5,955</u>	<u>7,864</u>	<u>8,677</u>	<u>8,317</u>
Total Revenues and Other Income	\$113,860	\$139,900	\$148,047	\$144,015	\$150,485
Operating Expenses					
Generation	\$ 26,799	\$ 21,966	\$ 22,277	\$ 23,462	\$ 22,919
Transmission	2,060	1,985	2,232	1,516	1,653
Administrative and General	16,308	15,435	14,895	15,396	18,617
License Compliance and Related Agreements	18,362	25,260	25,050	19,597	24,199
Taxes	<u>1,735</u>	<u>1,398</u>	<u>2,065</u>	<u>1,827</u>	<u>1,955</u>
Total Operating Expenses	<u>\$ 65,264</u>	<u>\$ 66,044</u>	<u>\$ 66,519</u>	<u>\$ 61,798</u>	<u>\$ 69,343</u>
Net Revenues	<u>\$ 48,596</u>	<u>\$ 73,856</u>	<u>\$ 81,528</u>	<u>\$ 82,217</u>	<u>\$ 81,142</u>
Transfer Requirements <sup>(3)</sup>	6,000	--	--	--	--
Unused bond proceeds refunded	--	16	--	--	--
Excess Available in Supplemental R&R Fund	<u>\$ 8,183</u>	<u>\$ 8,196</u>	<u>\$ 10,228</u>	<u>\$ 11,968</u>	<u>\$ 12,283</u>
Remaining Net Revenues Available for Debt Service on Parity Bonds	<u>\$ 62,779</u>	<u>\$ 82,068</u>	<u>\$ 91,756</u>	<u>\$ 94,185</u>	<u>\$ 93,425</u>
Debt Service on Parity Bonds	\$ 54,642	\$ 56,930	\$ 80,837	\$ 80,380	\$ 81,245
Debt Service Coverage on Parity Bonds <sup>(4)</sup>	1.15x	1.44x	1.14x	1.17x	1.15x
Net Energy Output (MWh) <sup>(5)</sup>	7,569,468	7,060,574	9,573,895	8,747,538	8,945,411
Average Cost (\$/MWh) <sup>(6)</sup>	\$14.58	\$18.97	\$14.64	\$15.47	\$15.89

(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) 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.

(4) 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 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. See "SECURITY FOR THE PARITY BONDS—Rate Covenants."

(5) Run-off was 82% of average in 2009, 81% of average in 2010, 126% of average in 2011, 120% of average in 2012 and 103% of average in 2013.

(6) 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. For 2013, the average cost will not match the number of \$16.31 reported in the Management Discussion and Analysis section of the 2013 audited financial statements issued on April 28, 2014, due to a calculation oversight.

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.

See “Wanapum Spillway Monolith Fracture” for a discussion of the impact of the fracture in the Wanapum Dam spillway monolith on 2014 operations.

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## Debt Service Requirements for the Priest Rapids Project

The following table gives debt service requirements for the Outstanding Parity Bonds and for the 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 reduction is currently 7.3%; the reduction was 7.2% from October 1, 2013 through September 30, 2014 and was 8.7% through September 30, 2013.

**Table 7**  
**PRIEST RAPIDS PROJECT PARITY BOND DEBT SERVICE REQUIREMENTS<sup>(1)</sup>**

Year <sup>(2)</sup>	Outstanding Parity Bonds <sup>(3)(4)</sup>			The Bonds			Aggregate Debt Service on Parity Bonds
	Priest Rapids	Wanapum	Priest Rapids Project	Principal	Interest	Total	
2015	\$ 15,349,922	\$ 16,741,705	\$ 39,303,383	\$ 470,000	\$ 5,678,428	\$ 6,148,428	\$ 77,543,438
2016	15,347,313	14,487,752	39,301,554	3,885,000	9,105,975	12,990,975	82,127,594
2017	12,993,204	14,456,828	39,283,378	6,235,000	8,940,625	15,175,625	81,909,035
2018	11,969,689	13,575,828	39,353,930	6,465,000	8,722,325	15,187,325	80,086,772
2019	10,585,222	12,492,811	38,881,842	5,770,000	8,466,850	14,236,850	76,196,725
2020	10,575,068	12,483,609	38,822,917	6,045,000	8,171,475	14,216,475	76,098,069
2021	10,573,804	12,485,278	38,738,467	6,360,000	7,861,350	14,221,350	76,018,899
2022	8,740,275	10,551,269	36,622,056	6,675,000	7,535,475	14,210,475	70,124,075
2023	8,737,409	10,548,925	36,561,720	7,015,000	7,193,225	14,208,225	70,056,279
2024	7,884,315	10,541,361	32,574,325	5,845,000	6,871,725	12,716,725	63,716,726
2025	7,871,806	10,533,184	32,493,515	6,130,000	6,572,350	12,702,350	63,600,855
2026	7,859,562	10,528,752	32,423,975	6,440,000	6,258,100	12,698,100	63,510,389
2027	7,866,753	10,519,572	119,783,367 <sup>(5)</sup>	6,765,000	5,927,975	12,692,975	150,862,667
2028	7,859,917	10,520,091	32,256,388	7,095,000	5,581,475	12,676,475	63,312,871
2029	7,843,400	10,512,736	32,054,520	7,445,000	5,217,975	12,662,975	63,073,631
2030	7,836,429	10,506,980	29,320,221	10,190,000	4,777,100	14,967,100	62,630,730
2031	7,831,977	10,502,040	29,114,255	9,865,000	4,275,725	14,140,725	61,588,997
2032	5,427,785	9,729,258	70,466,273 <sup>(6)</sup>	8,735,000	3,810,725	12,545,725	98,169,041
2033	5,422,147	9,718,759	26,901,568	9,185,000	3,362,725	12,547,725	54,590,199
2034	3,977,861	9,713,434	26,677,967	8,765,000	2,942,250	11,707,250	52,076,512
2035	3,966,509	9,707,371	26,436,072	9,145,000	2,568,500	11,713,500	51,823,452
2036	3,965,527	9,694,917	24,731,746	9,515,000	2,195,300	11,710,300	50,102,490
2037	--	9,685,285	24,480,171	9,895,000	1,807,100	11,702,100	45,867,556
2038	--	9,680,338	24,208,253	10,290,000	1,403,400	11,693,400	45,581,991
2039	--	9,668,927	26,819,197	4,515,000	1,107,300	5,622,300	42,110,424
2040	--	9,656,989	26,531,821	4,695,000	923,100	5,618,100	41,806,910
2041	--	9,648,363	9,890,375	4,885,000	731,500	5,616,500	25,155,238
2042	--	9,636,832	9,872,769	5,075,000	532,300	5,607,300	25,116,901
2043	--	9,621,356	9,866,658	5,280,000	325,200	5,605,200	25,093,214
2044	--	--	--	5,490,000	109,800	5,599,800	5,599,800
Total	<u>\$190,485,894</u>	<u>\$318,150,549</u>	<u>\$993,772,683</u>	<u>\$204,165,000</u>	<u>\$138,977,353</u>	<u>\$343,142,353</u>	<u>\$1,845,551,479</u>

- (1) Columns may not add due to rounding. Table does not include the Junior Lien Bond, which is expected to be issued in the amount of \$45,500,000 simultaneously with the Bonds. The Junior Lien Bond will have a lien on Net Revenues junior to all Outstanding and Future Parity Bonds.
- (2) Based on a calendar year, including January 1 and July 1 payments made in that year.
- (3) Excludes the Refunded Bonds.
- (4) Before federal credit payments.
- (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.

## 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 2013, the Electric System operated approximately 4,183 miles of lines and served approximately 46,969 retail customers. As of December 31, 2013, the District’s gross investment in the Electric System was \$957 million and its net investment was \$534 million. 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 2013 totaled approximately \$235 million. Of this total, approximately \$149.5 million (64%) was derived from retail energy sales to an average of 46,969 customers. Sales to other utilities provided approximately \$79.3 million of revenues (34% of the total). See “Power Supply Management and Power Marketing.” Of the retail customers, 76% were residential customers, providing 26% 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 from the Priest Rapids Project above its load since the Electric System’s rights to the output of the Priest Rapids Project are set at critical water annually. 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 24% of the overall revenue stream for the Electric System. The number of retail customers, energy sales and revenues for the year ended December 31, 2013, for each major retail customer class are listed below.

**Table 8**  
**ELECTRIC SYSTEM**  
**2013 RETAIL CUSTOMERS, ENERGY SALES AND REVENUES**

Customer Class <sup>(1)</sup>	Average Number of Customers		Energy Sold		Revenue <sup>(2)</sup>	
	Number	%	GWh <sup>(3)</sup>	%	\$000	%
Residential	35,680	75.96	774.6	19.83	39,491	26.41
Commercial	6,381	13.59	471.4	12.07	20,023	13.40
Large Commercial	95	0.20	272.7	6.98	8,188	5.48
Irrigation	4,668	9.94	541.8	13.87	20,873	13.96
Industrial	27	0.06	1,837.5	47.06	59,897	40.06
Other	118	0.25	6.5	0.19	1,033	0.69
<b>Total</b>	<b>46,969</b>	<b>100.00</b>	<b>3,904.5</b>	<b>100.00</b>	<b>149,505</b>	<b>100.00</b>

(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, 2013, are shown in the following table.

**Table 9**  
**ELECTRIC SYSTEM LARGEST CUSTOMERS**  
**(Listed alphabetically)**

Customer	Location	Product
Air Liquide Electronics U.S. LP	Moses Lake	Gases, liquids and molecules for silicon chips
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. <sup>(1)</sup>	Quincy/Warden	French fried potatoes
Microsoft Corp.	Quincy	Data center
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	Carbon-based products
Yahoo!	Quincy	Data center

(1) Lamb-Weston has facilities at two locations in the County.

The Electric System’s ten largest customers used approximately 42% of total retail energy sold and provided approximately 36% of retail revenues in 2013. The two largest customers used approximately 17% of total retail energy sold and provided approximately 16% of retail revenues in 2013. The District’s rate structure for industrial customers is designed to include the marginal cost of additional power purchases. The Priest Rapids Project 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 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 began operations in 2012, and completed its first expansion in 2014. Pacific Coast Canola finished construction of its facility in late 2012 and began processing in early 2013. Microsoft recently signed another agreement that will expand its data center operations in the County again with the new load expected to come online in 2015-2017. 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 21% 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 35% 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 10**  
**ELECTRIC SYSTEM**  
**RETAIL CUSTOMERS, ENERGY SALES, AND REVENUES**

	2009	2010	2011	2012	2013
Number of Customers (Average) <sup>(1)</sup>					
Residential	34,901	35,215	35,463	35,547	35,680
Commercial	5,899	5,999	6,080	6,193	6,381
Irrigation	4,541	4,553	4,573	4,624	4,668
Industrial	117	113	116	118	122
Other <sup>(1)</sup>	118	118	119	120	118
Total Customers	45,576	45,998	46,351	46,602	46,969
Energy Sales (MWh) <sup>(1)</sup>					
Residential	819,448	729,695	782,633	743,412	774,617
Commercial	467,134	439,988	467,188	457,325	471,432
Irrigation	541,930	503,706	509,086	536,381	541,816
Industrial	1,881,258	2,198,721	2,273,282	2,193,138	2,110,287
Other <sup>(2)</sup>	5,896	6,044	6,419	6,366	6,357
Total Energy Sales	3,715,666	3,878,154	4,038,608	3,936,622	3,904,509
System Peak (MW)					
Winter	660	643	655	615	653
Summer	640	662	664	665	669
Revenues from Energy Sales (\$000) <sup>(1)</sup>					
Residential	\$ 33,211	\$ 31,252	\$ 34,342	\$ 35,898	\$ 39,491
Commercial	15,658	15,507	17,114	18,380	20,023
Irrigation	16,422	16,295	17,271	19,501	20,873
Industrial	48,602	58,865	65,071	69,113	68,085
Other <sup>(2)</sup>	971	981	1,006	1,019	1,033
Total Revenues	\$ 114,864	\$ 122,900	\$ 134,804	\$ 143,911	\$ 149,505

(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 2009 to 2013 grew 12%.

### **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. 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 is 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 forward 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 table that follows 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 2009 through 2013. For information on 2014 to date, see "Management's Discussion of Results."

**Table 11**  
**ELECTRIC SYSTEM**  
**WHOLESALE ENERGY SALES<sup>(1)</sup>**

	2009	2010	2011	2012	2013
Wholesale Energy Sales (\$000) <sup>(1)</sup>	\$ 87,908	\$ 86,385	\$ 100,547	\$ 61,782	\$ 79,363
Total MWh <sup>(2)</sup>	3,111,968	2,777,244	3,927,447	2,334,279	2,554,266
Average Revenue (\$/MWh)	\$ 28.25	\$ 31.10	\$ 25.60	\$ 26.47	\$ 31.07

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

(2) Run-off was 82% of average in 2009, 81% of average in 2010, 126% of average in 2011, 120% of average in 2012 and 103% of average in 2013. Decrease in 2012 due to termination of the Displacement Sales associated with the prior Bonneville contract and the 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 is comprised of senior management in the areas of operations, power management, and financial risk and meets regularly to monitor activities and risk. 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.

Credit exposures are monitored routinely 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.

### **Slice Sales**

The District has entered into contracts to sell portions of the District’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 District has entered into an additional contract with Iberdrola commencing December 1, 2014 and terminating June 30, 2015. The Shell contract was 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 District are to hedge water volume and operational risks through greater portfolio diversification. The associated schedule of 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 are designed to increase District net revenue stability by improving the predictability of wholesale revenues. Slice sales have also provided protection against the operational impacts of the Wanapum monolith spillway fracture. See “THE PRIEST RAPIDS PROJECT—Wanapum Spillway Monolith Fracture.” 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 \$20.3 million contract with Iberdrola commencing December 1, 2014, is paid in 7 equal monthly installments over the life of the agreement. The District has the right to curtail delivery in the event of non-payment and maintains strong credit provision with all slice counterparties.

The District is monitoring and evaluating all hedging options. The District plans to maintain a hedge of approximately 30% or greater of the total Priest Rapids Project through “mid-term” slice sales to manage volatility of precipitation and wholesale revenues.



## **Potential Expansion and Enhanced Slice Sales Strategy**

The District has begun to consider expanding its use of the slice sales strategy to achieve further risk reduction. Recent study by the District has shown that risk reduction potential exists, without diminution of the expected net wholesale revenues, through expanded use of slice sales. The District could expand and enhance its slice sales strategy through either additional slice sales similar to those already undertaken or through sale of larger slice sales volumes, up to and including a single slice sale of its retained share of the Priest Rapids Project.

Through an expanded slice sales program, in whatever form, the District will be able to lay-off the risks and uncertainties associated with yearly variability in precipitation and wholesale revenues. This reduction in uncertainty will allow for greater certainty in revenues from wholesale sales over the contract term. Based upon indicative pricing, the District also expects that expanded slice sales would result in a greater margin on energy than the District currently forecasts in its budget.

Currently, the District is in the preliminary stages of exploring an enhanced slice sales strategy. If the District is successful in finalizing such an enhanced slice sales strategy and decides to move forward, any transaction(s) would likely be finalized in the latter part of the first quarter of 2015 with implementation to begin mid-year 2015. There can be no assurances the District will, in fact, enter into any transaction(s).

In the same general time-frame as the slice sale, and based upon the revenues from that sale, the District will buy some or all of the energy needed to serve retail customer loads during the term of the slice sale. In this way, the District will increase the certainty of both the availability and price of energy used to serve retail customers.

## **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 2013 was \$1,107 and the average cost per kWh for residential service (including city taxes) in the District was 5.10 cents.

**Table 12**  
**ELECTRIC SYSTEM**  
**MONTHLY ELECTRIC BILLS COMPARISON<sup>(1)</sup>**  
**As of July 1, 2014**  
**(Winter Rates where applicable)**

	Residential (1,500 kWh)	Commercial (30 kW 9,000 kWh)	Industrial (400 kW 150,000 kWh)
<b>The District</b>	\$79	\$386	\$4,778
<b>Washington State Public Utility Districts</b>			
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	111	746	10,680
Douglas County PUD No. 1	45	220	3,995
Franklin County PUD No. 1	129	681	9,615
Grays Harbor County PUD No. 1	139	786	11,826
Kittitas County PUD No. 1	149	806	9,765
Klickitat County PUD No. 1	141	602	10,507
Lewis County PUD No. 1	97	508	7,801
Mason County PUD No. 3	122	674	9,161
Snohomish County PUD No. 1	142	784	12,118
<b>Washington Cities</b>			
City of Ellensburg	107	618	9,081
City of Richland	105	452	7,045
City of Seattle	146	687	9,962
City of Tacoma	121	728	8,885
<b>Private Power Companies</b>			
Avista	127	939	13,199
Pacific Power (a PacifiCorp Company)	133	753	10,560
Portland General Electric	168	800	11,984
Puget Sound Energy	152	815	13,274

(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 13  
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
January 1, 2012	8
January 1, 2013	6
January 1, 2014	2

The District currently forecasts annual rate increases averaging 2% or less. The Commission has final authority over the timing and frequency of rate modifications.

**The Electric System’s Power Supply**

In 2013, 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 32,359 MWh in 2013.

***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 20,739 MWh in 2013.

***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 (5 aMW or roughly 1% of the total District load). 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 a standard point-to-point ("PTP") transmission contract with Bonneville that was acquired for the purpose of transmitting Priest Rapids Project power to District load. This 150 MW PTP contract expires on December 31, 2015. The five-year contract contains long-term rollover rights, but it is unlikely the District will exercise these rights. The contract was obtained to move Priest Rapids Project power to the District's loads. With the completion of the District's Columbia-Rocky Ford 230 kV transmission line, this contract is no longer needed for its original purpose. The District currently sells the rights in this contract to other parties on a monthly or quarterly basis.

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, a substantial 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 4,380 MWh in 2012, was approximately 4,195 MWh in 2013 and is expected to be approximately 4,200 MWh in 2014. 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.

### ***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, and subsequently refinanced, through the issuance of revenue bonds by Energy Northwest, of which \$36,520,000 is outstanding and that 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, 2013 was \$73.76 per MWh. The projected net cost for calendar year 2014 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 2013, the District received approximately 27,872 MWh of wind generation output from the project and the District is projecting output from the project to be about 30,600 MWh in 2014.

### ***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.

Conservation opportunities are being actively pursued by the District to achieve 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 the State's Energy Independence Act (Initiative 937), the District set a 10-year conservation target (MWh's) for the years 2010 through 2019 and reviews and sets new 10-year targets every two years along with a biennial target. These targets are being met by conservation from existing programs and any new conservation programs created during the target period. See "Legislation and Initiatives" below.

Since the reduction of Bonneville's conservation funding in October 2011, the District set a two-year conservation target (2012/2013 biennial target) of 99,853 MWhs. This target was met with 94,400 MWh of conservation at an incentive cost of \$6,581,727 and transmission and distribution line loss savings of 23,038 MWh. The 2014/2015 biennial target was set at 32,675 MWh, and the District has saved 6,813 MWh at an incentive cost of \$798,270 thus far toward this target.

## ***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 \$1.787 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"), approved by the State's voters in 2006, 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, 2013 and 2014 targets for renewable energy under I-937. The District fully expects that its available qualifying renewable generation will continue to 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, 2013, the District's Wholesale Fiber Optic Network was available to 26,967 homes and businesses within Grant County. Currently 8,287 users subscribe to services from the existing group of retail providers. The Wholesale Fiber Optic Network currently has about 17 internet service providers, one telephone service provider, and two video service providers, 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 2012 and 2013, the District spent \$11.235 million and \$11.254 million, respectively, for Wholesale Fiber Optic Network expansion and capital improvements. The approved capital budget for 2014 includes \$7 million and forecasts an additional \$5 million through 2016. The District experienced a 20% growth in wholesale fiber services revenue in 2013 compared to 2012.

The Wholesale Fiber Optic Network is operated and accounted for as part of the Electric System. Through the year ended December 31, 2013, the District had invested more than \$150 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. Approximately 59% of the build out was complete as of December 31, 2013. These net operating losses (including depreciation) currently amount to approximately \$2.5 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 C—"AUDITED FINANCIAL STATEMENTS OF THE DISTRICT AS OF DECEMBER 31, 2013 AND 2012," including in particular Note 11, for additional financial and other information regarding the District's telecommunications system.

### *NoaNet*

The District withdrew its membership in Northwest Open Access Network (“NoaNet”) in July 2014, but remains a participant with respect to certain debt of NoaNet. NoaNet, a Washington nonprofit mutual corporation, was established in 2000 and currently is comprised of nine other Washington public utility districts and Energy Northwest to provide its members with a broadband communications backbone throughout the State using “public benefit” fibers leased by NoaNet from Bonneville. NoaNet was created 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 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 \$1.43 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 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. No contributions by the District were required for 2012 or 2013.

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## 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 14**  
**SUMMARY OF OUTSTANDING LONG TERM DEBT OF THE DISTRICT**  
**As of August 1, 2014**

System <sup>(1)</sup>	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	\$ 78,120	\$ 223,695	\$ 145,745			
	2013-J	1/1/2041	67,625	67,625					
Priest Rapids Development	2003-Z	1/1/2021	\$ 18,450	\$ 10,285	224,575	164,040			
	2005-A	1/1/2033	69,050	46,390 <sup>(2)</sup>					
	2005-B	1/1/2033	26,780	21,640					
	2005-Z	1/1/2033	43,685	31,620					
	2006-A	1/1/2036	24,770	21,220					
	2006-B	1/1/2017	5,470	1,025					
	2006-Z	1/1/2036	36,370	31,860					
Wanapum Development	2003-Z	1/1/2021	\$ 20,135	\$ 11,225	334,345	257,345			
	2005-A	1/1/2038	52,325	23,735 <sup>(2)</sup>					
	2005-B	1/1/2038	71,050	61,200 <sup>(2)</sup>					
	2005-Z	1/1/2018	4,405	1,755					
	2006-A	1/1/2043	71,395	60,975					
	2006-B	1/1/2031	18,190	10,280					
	2006-Z	1/1/2043	96,845	88,175					
Priest Rapids Project	2010-A	1/1/2023	\$ 40,265	\$ 25,175	577,120	550,320			
	2010-B	1/1/2018	10,665	6,040					
	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	33,270					
	2012-A	1/1/2035	54,510	51,545					
	2012-B	1/1/2023	16,235	14,260					
	2012-M	1/1/2032	42,395	42,395					
	2012-Z	1/1/2035	14,480	13,845					
	2013-A	1/1/2043	69,690	69,690					
	2013-Z	1/1/2043	30,380	30,185					
	<b>Total</b>			<b>\$ 1,359,735</b>			<b>\$ 1,117,450</b>	<b>\$ 1,359,735</b>	<b>\$ 1,117,450</b>

(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.

(2) A portion to be refunded with Bond proceeds.

## Electric System Operating Results

The following table shows the Electric System's historical operating results for fiscal years 2009 through 2013. 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 C, because it does not follow all of the accounting principles generally accepted in the United States.

**Table 15**  
**ELECTRIC SYSTEM HISTORICAL OPERATING RESULTS**  
**(\$000)**

	2009	2010	2011	2012	2013
<b>Revenues</b>					
Retail Energy Sales	\$ 114,864	\$ 122,900	\$ 134,804	\$ 143,911	\$ 149,505
Miscellaneous Electrical Revenues <sup>(1)</sup>	5,172	13,236	13,370	9,053	17,885
Sales to Other Utilities <sup>(2)</sup>	87,908	86,385	100,547	61,782	79,363
<b>Total Revenues</b>	<b>\$ 207,944</b>	<b>\$ 222,521</b>	<b>\$ 248,721</b>	<b>\$ 214,746</b>	<b>\$ 246,753</b>
<b>Expenses</b>					
Power Supply Costs <sup>(3)</sup>	\$ 127,015	\$ 148,349	\$ 143,769	\$ 107,774	\$ 123,897
Operation and Maintenance <sup>(4)</sup>	29,457	31,121	29,000	32,602	35,880
Taxes	8,800	8,983	10,153	10,443	11,776
<b>Total Expenses</b>	<b>\$ 165,272</b>	<b>\$ 188,453</b>	<b>\$ 182,922</b>	<b>\$ 150,819</b>	<b>\$ 171,553</b>
<b>Net Revenues</b>	<b>\$ 42,672</b>	<b>\$ 34,068</b>	<b>\$ 65,799</b>	<b>\$ 63,927</b>	<b>\$ 75,200</b>
<b>Interest and Other Income</b>	<b>\$ 1,644</b>	<b>\$ 577</b>	<b>\$ 949</b>	<b>\$ 1,273</b>	<b>\$ (96)</b>
<b>Transfer to the Rate Stabilization Account<sup>(5)</sup></b>					
	--	--	(20,000)	--	(38,900)
<b>Revenues Available for Debt Service</b>	<b>44,316</b>	<b>34,645</b>	<b>46,748</b>	<b>65,200</b>	<b>36,204</b>
<b>Less Debt Service<sup>(6)</sup></b>	<b>(17,922)</b>	<b>(17,906)</b>	<b>(27,314)</b>	<b>(9,464)</b>	<b>(18,007)</b>
<b>Uncommitted Revenues</b>	<b>\$ 26,394</b>	<b>\$ 16,739</b>	<b>\$ 19,434</b>	<b>\$ 55,736</b>	<b>\$ 18,197</b>
<b>Beginning Working Capital</b>	<b>\$ 183,107</b>	<b>\$ 141,303</b>	<b>\$ 103,361</b>	<b>\$ 199,232</b>	<b>\$ 176,940</b>
<b>Bond Proceeds – Construction Fund</b>	<b>--</b>	<b>--</b>	<b>100,000</b>	<b>--</b>	<b>--</b>
<b>Funds Available for Construction</b>	<b>209,501</b>	<b>158,042</b>	<b>222,795</b>	<b>254,968</b>	<b>195,137</b>
<b>Less Capital Construction</b>	<b>(61,570)</b>	<b>(36,611)</b>	<b>(27,018)</b>	<b>(46,203)</b>	<b>(69,125)</b>
<b>Change in Other Balance Sheet Accounts</b>	<b>(6,628)</b>	<b>(18,070)</b>	<b>3,455</b>	<b>(31,825)</b>	<b>28,035</b>
<b>Ending Working Capital<sup>(7)</sup></b>	<b>\$ 141,303</b>	<b>\$ 103,361</b>	<b>\$ 199,232</b>	<b>\$ 176,940</b>	<b>\$ 154,047</b>
<b>Reserve and Contingency Fund<sup>(8)</sup></b>	<b>\$ 95,072</b>	<b>\$ 96,118</b>	<b>\$ 71,806</b>	<b>\$ 72,070</b>	<b>\$ 120,111</b>
<b>Debt Service Coverage</b>	<b>2.47x</b>	<b>1.93x</b>	<b>1.71x</b>	<b>6.89x</b>	<b>2.01x</b>
<b>Retail Energy Sales (MWh)</b>	<b>3,715,666</b>	<b>3,878,154</b>	<b>4,038,608</b>	<b>3,936,622</b>	<b>3,904,509</b>
<b>Average Retail Energy Rate Increase</b>	<b>0%</b>	<b>4%</b>	<b>6%</b>	<b>8%</b>	<b>6%</b>
<b>Average Retail Revenue Requirement (cents/kWh)</b>	<b>3.09¢</b>	<b>3.17¢</b>	<b>3.34¢</b>	<b>3.66¢</b>	<b>3.83¢</b>

(1) The District recognized earned contributions in aid of construction of \$11,966,256, \$3,847,424, \$8,660,241, \$8,871,577 and \$993,576 in 2013, 2012, 2011, 2010 and 2009, respectively.

(2) The increase in 2011 was largely due to higher water flows (126% of average). 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 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 2013 and 2011, pursuant to Commission resolutions, \$38.9 million and \$20 million, respectively, were transferred to the Rate Stabilization Account from the Revenue Fund.

(6) Due to the 2011 Electric System bond issue and the effect on the timing of debt service payments, the debt service payment due on January 1, 2012 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, 2014, the balance in the Reserve and Contingency Fund was \$120.5 million. \$109.6 million of this balance is designated as available for rate stabilization for debt service coverage purposes.

The following table shows the Electric System's historical energy requirements, resources and power costs for fiscal years 2009 through 2013.

**Table 16**  
**ELECTRIC SYSTEM**  
**HISTORICAL ENERGY REQUIREMENTS, RESOURCES AND POWER COSTS**

	2009	2010	2011	2012	2013
Annual Energy Requirements (MWh)					
Retail Sales <sup>(1)</sup>	3,693,343	3,878,190	4,058,471	3,910,618	3,906,449
Electrical System Usage	11,892	11,336	11,307	13,412	14,721
Sales for Resale <sup>(2)</sup>	3,111,968	2,777,244	3,927,447	2,334,279	2,554,266
Distribution/Transmission Line Losses	175,698	148,431	165,766	199,481	136,807
Total Energy Requirements	6,992,901	6,815,201	8,162,991	6,457,790	6,612,243
Annual Resources (MWh)					
Priest Rapids Project <sup>(3)</sup>	3,651,136	4,036,382	5,715,363	5,337,812	5,520,331
Quincy Chute Project	32,805	32,336	32,430	33,271	32,359
PEC Headworks Project	20,700	22,746	13,314	23,043	20,739
Bonneville <sup>(4)</sup>	1,704,937	1,704,796	1,352,243	50,027	58,831
Other	1,583,323	1,018,941	1,049,641	1,013,637	979,983
Total Energy Resources	6,992,901	6,815,201	8,162,991	6,457,790	6,612,243
Average Power Cost by Resource (cents/kWh)					
Priest Rapids Project <sup>(3)</sup>	1.68¢	1.97¢	1.53¢	1.55¢	1.64¢
Quincy Chute Project	2.35	2.72	2.71	2.88	2.45
PEC Headworks Project	2.94	3.24	6.62	2.71	3.08
Bonneville	2.48	2.60	2.43	3.24	3.47
Annual Power Cost by Resource (\$000)					
Priest Rapids Project <sup>(3)</sup>	\$ 61,199	\$ 79,698	\$ 87,179	\$ 82,985	\$ 86,527
Quincy Chute Project	771	879	880	958	793
PEC Headworks Project	609	736	882	624	638
Bonneville <sup>(4)</sup>	42,323	44,244	32,908	1,620	2,042
Other <sup>(5)</sup>	13,924	13,593	12,789	14,654	27,626
Wheeling	8,189	9,199	9,131	6,933	6,271
Total Power Costs (\$000)	\$ 127,015	\$ 148,349	\$ 143,769	\$ 107,774	\$ 123,897
Average Power Costs (cents/kWh)	1.82¢	2.18¢	1.76¢	1.67¢	1.87¢

(1) Reflects total retail energy requirements.

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

(3) During 2010, 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 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.

## 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 2009 to 2013 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. For 2009 and 2010, 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 15. The years 2011 and 2012 had significant run-off (126% and 120% of average, respectively), and wholesale market prices continued to be low. This resulted in net revenues of \$66 million and \$64 million for 2011 and 2012, respectively. For 2013, the

run-off was 103% of average and the District was able to generate net revenue of \$75 million. During 2013, the District was able to increase the Reserve and Contingency Fund by \$48 million to a total of over \$120 million.

The District has always met its debt service coverage covenants. The District added to its Rate Stabilization Account in 2006, 2007, 2011 and 2013. From 2009 to 2013, the Electric System's debt service coverage ranged from 1.71 times to 6.89 times, well in excess of the 1.25 times required by the Electric System bond resolutions.

The Commission approved a 2% rate increase effective January 1, 2014, following 6%, 8%, 6% and 4% increases in 2013, 2012, 2011 and 2010, respectively. The District forecasts annual rate increases of 2% or less in 2015 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 six times in 2014.

### 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 2014-2018 to be approximately \$244 million. The District is undertaking substantial capital improvements to serve expected load growth. 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 improvements are expected to be financed primarily by revenues; the Electric System bonds expected to be issued in 2014 are expected to finance approximately \$50 million of the improvements. In addition, the District expects to issue approximately \$100 million in two series of Electric System revenue bonds in 2015 and 2016.

**Table 17**  
**ELECTRIC SYSTEM PROJECTED**  
**CAPITAL IMPROVEMENTS PROGRAM 2014-2018<sup>(1)</sup>**

Distribution	\$ 103,891,000
Transmission	74,785,000
Fiber	31,927,000
General Plant	28,275,000
	\$ 243,878,000

(1) These figures in the Preliminary Official Statement were net of contributions in aid of construction.

## **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, including energy imbalance markets, (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) effects of competition from other electric utilities (including increased competition resulting from mergers, acquisitions, and “strategic alliances” of competing electric and natural gas utilities and from competitors transmitting less expensive electricity from much greater distances over an interconnected system) and new methods of, and new facilities for, producing low-cost electricity, (6) Federal laws and regulations and congressional inaction, (7) increased competition from independent power producers and marketers, brokers and federal power marketing agencies, (8) issues integrating wind generation, (9) cybersecurity and other security breaches, (10) “self-generation” or “distributed generation” (such as microturbines and fuel cells) by industrial and commercial customers and others, (11) issues relating to the ability to issue tax-exempt obligations, including severe 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, (12) effects of inflation on the operating and maintenance costs of an electric utility and its facilities, (13) changes from projected future load requirements, (14) increases in costs and uncertain availability of capital, (15) shifts in the availability and relative costs of different fuels (including the cost of natural gas), (16) 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 in an area of the country experiencing such high peak demand, such as has occurred in California and the Pacific Northwest, (17) inadequate risk management procedures and practices with respect to, among other things, the purchase and sale of energy and transmission capacity, (18) other legislative changes, voter initiatives, referenda and statewide propositions, (19) effects of the changes in the economy, (20) effects of possible manipulation of the electric markets, (21) natural disasters or other physical calamities, including, but not limited to, earthquakes, mudslides, wind storms and floods, (22) man-made physical and operational disasters, including, but not limited to, terrorism, cyber attacks and collateral damage from untargeted computer viruses, (23) failures or problems with dams and other equipment and infrastructure and (24) 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 after 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.

## **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 2014 population of 21,600, and Ephrata, the County seat, is the second largest with a 2014 population of 7,930. Population density in the County in 2014 was 34.67 persons per square mile ranking it 21<sup>st</sup> of the 39 counties in the State. The total civilian labor force in the County in 2014 is 41,000.

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 United States 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 18**  
**GRANT COUNTY**  
**SELECTED ECONOMIC INDICATORS**

	Population <sup>(1)</sup>	Per Capita Personal Income <sup>(2)</sup>	Taxable Retail Sales (\$000) <sup>(3)</sup>	Value of Building Permits (\$000) <sup>(4)</sup>	Personal Income (\$000) <sup>(2)</sup>
2014	92,900	--	--	--	--
2013	91,800	--	\$ 1,818,642	--	--
2012	91,000	\$ 32,342	1,588,877	\$ 65,127	\$ 2,966,473
2011	90,100	32,403	1,491,166	51,426	2,941,395
2010	89,120	30,380	1,215,315	72,488	2,723,394
2009	86,100	30,024	1,225,954	41,432	2,622,265
2008	84,600	30,972	1,551,866	76,211	2,630,856
2007	82,500	28,148	1,537,951	121,243	2,326,299
2006	80,600	25,389	1,107,853	78,601	2,057,397
2005	79,100	24,953	872,602	78,572	1,984,525

- (1) *Source:* Washington State Office of Financial Management; information for 2010 is from the United States Bureau of the Census.
- (2) *Source:* Washington State Bureau of Economic Analysis; 2012 is most recent data available. The 2012 per capita personal income for the State was \$46,045.
- (3) *Source:* Washington State Department of Revenue; 2014 not yet available.
- (4) *Source:* Grant County Building Department; 2012 is the most recent data available.

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**Table 19**  
**GRANT COUNTY MAJOR PROPERTY TAXPAYERS<sup>(1)</sup>**

Taxpayer	Business	Assessed Valuation	% of County Assessed Valuation
Microsoft Corporation	Data Center/Technology	\$ 465,000,000	5.57%
REC Solar Grade Silicon, LLC	Chemical Manufacturing	280,626,625	3.36
Yahoo, Inc.	Data Center/Technology	200,200,400	2.40
Quincy Data Center LLC	Data Center/Technology	132,077,120	1.58
Dell Marketing LP	Data Center/Technology	100,000,000	1.20
SGL Automotive Carbon Fibers LLC	Carbon Manufacturing	61,362,500	0.74
Pacific Coast Canola LLC	Canola Oil Manufacturing	60,697,885	0.73
Intuit Inc.	Data Center/Technology	57,922,880	0.69
J. R. Simplot Co.	Potato Products	52,934,080	0.63
Conagra Foods Lamb-Weston Inc.	Potato Products	44,343,260	0.53
BNSF Railway Company Tax Dept.	Railroads	44,338,991	0.53
Intergate Quincy LLC	Data Center/Technology	41,500,000	0.50
Columbia Colstor, Inc.	Cold Storage	40,229,535	0.48
Moses Lake Industries Inc.	Chemical Manufacturing	37,854,750	0.45
Chemi-Con Materials Corp.	Chemical Manufacturing	35,012,750	0.42
Inflation Systems Inc.	Air Bag Products	35,000,000	0.42
Lamb-Weston BSW, LLC	Potato Products	29,599,900	0.35
Guardian Fiberglass Inc.	Fiberglass	26,526,525	0.32
EKA Chemicals	Chemicals	25,710,390	0.31
National Frozen Foods Corp.	Frozen Foods	22,916,220	0.27
Air Liquide Electronics US LP	Gases, liquids and molecules for silicon chips	21,741,830	0.26
American Potato Co.	Potato Products	17,371,795	0.21
Oregon Potato Company	Potato Products	17,245,010	0.21
IAC Search & Media WA LLC	Data Center	16,517,415	0.20
William G. and Jeannette Evans	Real Estate	15,332,830	0.18
		\$ 1,882,062,691	22.55%

(1) Total County assessed valuation for 2014 taxes is \$8,643,795,844.

Source: Grant County Assessor for tax collection year 2014.

**Table 20**  
**GRANT COUNTY MAJOR EMPLOYERS**

Employer	Product/Service	Employees
Genie Industries, Inc.	Aerial Work Platforms	1,400
Moses Lake School District	Education	951
The District <sup>(1)</sup>	Electric Utility	661
Grant County Government	Government	633
Wal-Mart	General Retail & Grocery Retail	615
Lamb Weston/BSW	Frozen Potato Processing	500
Samaritan Healthcare	Health Care	473
ConAgra Foods, Inc.	Frozen Potato Processing	460
REC Silicon	Polysilicon Manufacturing	450
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
Ephrata School District	Education	315
National Frozen Foods	Corn & Pea Processing	275
Confluence Health Moses Lake Clinic	Health Care	260
Moses Lake Industries, Inc.	Corporate Headquarters & Industrial Chemical	240
Moses Lake Community Health	Health Care	234
Washington Potato Co.	Dehydrated Potato Flake Processing	190
D&L Foundry, Inc.	Manhole Cover Manufacturing	184
Big Bend Community College	Education	180
Columbia Basin Hospital	Health Care	170
Columbia Colstor	Cold Storage	160
SGL Automotive Carbon Fiber	Carbon Fiber	126
Eldorado Stone	Stone and Brick Processing	100
International Paper	Corrugated Box Manufacturing	100

(1) The District's employee count, including full-time equivalent, part-time and temporary employees.  
Source: Grant County Economic Development Council as of June 2014.

**Table 21**  
**GRANT COUNTY RESIDENT CIVILIAN LABOR FORCE AND EMPLOYMENT<sup>(1)</sup>**

	Annual Averages					
	2009	2010	2011	2012	2013	2014 <sup>(2)</sup>
Total Labor Force	41,960	41,700	40,890	41,180	40,690	41,000
Employment	37,820	37,180	36,720	37,520	38,020	37,710
Unemployment	4,140	4,520	4,170	3,960	3,670	3,290
Unemployment Rate	9.9%	10.8%	10.2%	9.6%	8.8%	8.0%

(1) Not seasonally adjusted.

(2) Average through July 2014.

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



**Table 22**  
**GRANT COUNTY NONAGRICULTURAL EMPLOYMENT (1)**

NAICS Industry Title	Annual Averages					
	2009	2010	2011	2012	2013	2014 <sup>(2)</sup>
Total Nonfarm	26,600	26,470	27,180	27,370	27,990	28,190
Total Private	18,760	18,610	19,290	19,490	19,620	19,280
Goods Producing	5,430	5,200	5,620	5,750	5,730	5,950
Mining, Logging & Construction	1,490	1,200	1,200	1,210	1,150	1,150
Manufacturing	3,950	4,000	4,420	4,540	4,590	4,800
Services Providing	21,170	21,270	21,560	21,620	22,250	22,240
Trade, Transport. & Utilities	5,390	5,380	5,400	5,640	5,630	5,640
Information & Financial Activities	980	1,080	1,150	1,070	1,230	1,150
Professional & Business Services	1,110	1,150	1,260	1,250	1,310	1,430
Education & Health Services	2,750	2,930	2,960	2,870	2,770	2,750
Leisure & Hospitality	2,470	2,280	2,290	2,310	2,360	2,200
Government	7,760	7,840	7,850	7,850	8,110	8,160

(1) Not seasonally adjusted.

(2) Average through July 2014.

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 Parity 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 *Kelly 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 condone 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 D.

A municipality such as the District must be specifically authorized under state law in order to seek relief under Chapter 9 of the United States 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**

### **2014A Bonds**

***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 2014A Bonds, interest on the 2014A 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 and corporations.

***Continuing Requirements.*** The District is required to comply with certain requirements of the Code after the date of issuance of the 2014A Bonds in order to maintain the exclusion of the interest on the 2014A Bonds from gross income for federal income tax purposes, including, without limitation, requirements concerning the qualified use of 2014A Bond proceeds and the facilities financed or refinanced with 2014A Bond proceeds, limitations on investing gross proceeds of the 2014A Bonds in higher yielding investments in certain circumstances, and the requirement to comply with the arbitrage rebate requirement to the extent applicable to the 2014A 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 2014A Bonds could become taxable retroactive to the date of issuance of the 2014A 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 2014A 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 2014A 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 2014A 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 2014A Bonds may be subject to the foreign branch profits tax imposed by Section 884 of the Code when the 2014A 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 2014A 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 2014A Bonds. Depending on all the facts and circumstances and the type of audit involved, it is possible that commencement of an audit of the 2014A Bonds could adversely affect the market value and liquidity of the 2014A Bonds until the audit is concluded, regardless of its ultimate outcome.

***2014A 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 \$10,000,000 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 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 2014A 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 2014A Bonds is deductible for federal income tax purposes.

***Original Issue Premium.*** The 2014A Bonds have been sold at prices reflecting original issue premium ("2014A Premium Bonds"). An amount equal to the excess of the purchase price of a 2014A Premium Bond over its stated redemption price at maturity constitutes premium on such 2014A Premium Bond. A purchaser of a 2014A Premium Bond must amortize any premium over such 2014A 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 2014A Premium Bond will offset a like amount of qualified stated interest on such 2014A 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 2014A 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 2014A Premium Bond prior to its maturity. Even though the purchaser's basis is reduced, no federal income tax deduction is allowed. Purchasers of 2014A 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 2014A Premium Bonds.

***Reduction of Loss Reserve Deductions for Property and Casualty Insurance Companies.*** Under Section 832 of the Code, interest on the 2014A 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 owners of the 2014A Bonds who are also recipients of certain Social Security and certain Railroad Retirement benefits to take receipts or accruals of interest on the 2014A Bonds into account in determining gross income.

***Other Possible Federal Tax Consequences.*** Receipt of interest on the 2014A Bonds may have other federal tax consequences as to which prospective purchasers of the 2014A Bonds may wish to consult their own tax advisors.

***Potential Future Federal Tax Law Changes.*** From time to time, there are legislative proposals in Congress which, if enacted into law, could adversely affect the tax treatment, market value or marketability of the 2014A Bonds. It cannot be predicted whether future legislation may be proposed or enacted that would affect the federal tax treatment of interest received on the Bonds. Prospective purchasers of the 2014A Bonds should consult with their own tax advisors regarding any proposed or pending legislation that would change the federal tax treatment of interest on the 2014A Bonds.

## **2014B Bonds**

***Exclusion from Gross Income.*** In the opinion of Bond Counsel, under existing federal law and assuming compliance by the District with applicable requirements of the Code and Section 1317(25) of the Tax Reform Act of 1986, that must be satisfied subsequent to the issue date of the 2014B Bonds, interest on the 2014B Bonds (except any 2014B Bond for any period during which it is held by a “substantial user” of the Priest Rapids Project or a “related person” within the meaning of Section 147(a) of the Code) is excluded from gross income for federal income tax purposes. Interest on the 2014B Bonds received by individuals and corporations also may be subject to the federal alternative minimum tax. See “Alternative Minimum Tax” below.

***Continuing Requirements.*** The District is required to comply with certain requirements of the Code and Section 1317(25) of the Tax Reform Act of 1986, after the date of issuance of the 2014B Bonds in order to maintain the exclusion of the interest on the 2014B Bonds from gross income for federal income tax purposes, including, without limitation, requirements concerning the qualified use of 2014B Bond proceeds and the facilities financed or refinanced with 2014B Bond proceeds, limitations on investing gross proceeds of the 2014B Bonds in higher yielding investments in certain circumstances, and the requirement to comply with arbitrage rebate requirements to the extent applicable to the 2014B 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 2014B Bonds could become taxable retroactive to the date of issuance of the 2014B Bonds. Bond Counsel has not undertaken and does not undertake to monitor the District’s compliance with such requirements.

***Alternative Minimum Tax.*** Interest on the 2014B Bonds received by both individuals and corporations may be subject to an alternative minimum tax. Under the federal alternative minimum tax provisions of the Code, interest on certain bonds issued by or on behalf of governmental units to finance facilities used by nongovernmental persons (“specified private activity bonds”) will constitute a tax preference item for purposes of the alternative minimum tax applicable to both individuals and corporations. The 2014B Bonds are specified private activity bonds, and these alternative minimum tax provisions will apply to recipients of interest on the 2014B Bonds.

***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 2014B 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 its

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 2014B Bonds may be subject to the foreign branch profits tax imposed by Section 884 of the Code when the 2014B 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 IRS has established a general audit program to determine whether issuers of tax-exempt obligations, such as the 2014B 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 2014B Bonds. Depending on all the facts and circumstances and the type of audit involved, it is possible that commencement of an audit of the 2014B Bonds could adversely affect the market value and liquidity of the 2014B Bonds until the audit is concluded, regardless of its ultimate outcome.

***2014B 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 specified private activity bonds, such as the 2014B Bonds, acquired after August 7, 1986, will be disallowed as a tax deduction.

***Original Issue Premium.*** The 2014B Bonds have been sold at prices reflecting original issue premium (“2014B Premium Bonds”). An amount equal to the excess of the purchase price of a 2014B Premium Bond over its stated redemption price at maturity constitutes premium on such 2014B Premium Bond. A purchaser of a 2014B Premium Bond must amortize any premium over such 2014B 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 2014B Premium Bond will offset a like amount of qualified stated interest on such 2014B 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 2014B 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 2014B Premium Bond prior to its maturity. Even though the purchaser’s basis is reduced, no federal income tax deduction is allowed. Purchasers of 2014B 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 2014B Premium Bonds.

***Reduction of Loss Reserve Deductions for Property and Casualty Insurance Companies.*** Under Section 832 of the Code, interest on the 2014B 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 owners of the 2014B Bonds who are also recipients of certain Social Security and certain Railroad Retirement benefits to take receipts or accruals of interest on the 2014B Bonds into account in determining gross income.

***Other Possible Federal Tax Consequences.*** Receipt of interest on the 2014B Bonds may have other federal tax consequences as to which prospective purchasers of the 2014B Bonds may wish to consult their own tax advisors.

***Potential Future Federal Tax Law Changes.*** From time to time, there are legislative proposals in Congress which, if enacted, could require changes in the description of federal tax matters relating to the 2014B Bonds set forth above or adversely affect the market value of the 2014B Bonds. It cannot be predicted whether future legislation may be proposed or enacted that would affect the federal tax treatment of interest received on the 2014B Bonds. Prospective purchasers of the 2014B Bonds should consult with their own tax advisors regarding any proposed or pending legislation that would change the federal tax treatment of interest on the 2014B Bonds.

## **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 D. 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.

## **UNDERWRITING**

The Underwriters have agreed, subject to certain conditions, to purchase the 2014A Bonds and 2014B Bonds from the District at underwriter's discounts of \$655,944 and \$231,351, respectively. The Underwriters' obligations are subject to certain conditions precedent, and they will be obligated to purchase all 2014A Bonds and 2014B Bonds, if any Bonds of such series 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.

Citigroup Global Markets Inc., an underwriter of the Bonds, has informed the District that it has entered into a retail distribution agreement with each of TMC Bonds L.L.C. ("TMC") and UBS Financial Services Inc. ("UBSFS"). Under these distribution agreements, Citigroup Global Markets Inc. may distribute municipal securities to retail investors through the financial advisor network of UBSFS and the electronic primary offering platform of TMC. As part of this arrangement, Citigroup Global Markets Inc. may compensate TMC (and TMC may compensate its electronic platform member firms) and UBSFS for their selling efforts with respect to the Bonds.

J.P. Morgan Securities LLC ("JPMS"), an underwriter of the Bonds, has informed the District that it has entered into a negotiated dealer agreement (the "Dealer Agreement") with Charles Schwab & Co., Inc. ("CS&Co.") for the retail distribution of certain securities offerings, including the Bonds, at the original issue prices. Pursuant to the Dealer Agreement, (if applicable to this transaction), 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 CS&Co. sells.

Morgan Stanley, parent company of Morgan Stanley & Co. LLC, an underwriter of the Bonds, has informed the District that it has entered into a retail distribution arrangement with Morgan Stanley Smith Barney LLC. As part of the distribution arrangement, Morgan Stanley & Co. LLC may distribute municipal securities to retail investors through the financial advisor network of Morgan Stanley Smith Barney LLC. As part of this arrangement, Morgan Stanley & Co. LLC 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 municipal securities or any other negotiable instruments.

#### **CONTINUING DISCLOSURE**

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 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 (commencing in 2015 for the Fiscal Year ended December 31, 2014):

(1) The audited financial statements of the District 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 audited financial statements of the District 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 Priest Rapids Project and the Electric System;

(3) Participation in the Priest Rapids Project by customer name and percentage share of output and disposition of net energy;

(4) Maximum one-hour production and average production costs, net generation, plant availability factor and annual availability factor for the Priest Rapids Project;

(5) Priest Rapids Project operating results and debt service coverage on the outstanding Priest Rapids Parity Bonds;

(6) Electric System retail customers, energy sales, peak loads and revenues;

(7) Electric System operating results and debt service coverage on the outstanding Electric System parity bonds;

(8) Electric System energy requirements, resources and power costs; and

(9) The aggregate amount and percentage of total energy sold and of retail revenues provided by the Electric System’s ten largest customers.

Items 2 through 9, inclusive, shall be required only to the extent that such information is not included in the information provided pursuant to item 1 above.

Such annual financial information and operating data described above shall be provided on or before nine months after the end of the District’s Fiscal Year. The District may adjust such Fiscal Year by providing written notice of the change of Fiscal Year to the MSRB. Such annual financial information and operating data 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.

The District further agrees to provide or cause to be provided to the MSRB information with respect to each “Obligated Person” (if any) as follows: (1) To the extent the Obligated Person is a publicly traded company and that

such information is at the time on file with the SEC pursuant to the Securities Exchange Act of 1934 (the “Exchange Act”) references to such party’s most recent annual report, quarterly reports and current reports. (2) To the extent that an Obligated Person is not required to file information with the SEC pursuant to the Exchange Act, the District agrees to provide or cause to be provided to the MSRB information with respect to such Obligated Person as set forth below, in each case only if and to the extent applicable to such Obligated Person:

(a) Such Obligated Person’s audited financial statements prepared in accordance with generally accepted accounting principles; provided, that if such Obligated Person’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;

(b) Such Obligated Person’s outstanding long term indebtedness;

(c) Such Obligated Person’s retail customers, energy sales, peak loads and revenues;

(d) Such Obligated Person’s operating results and debt service coverage on its outstanding indebtedness;

(e) Such Obligated Person’s energy requirements, resources and power costs.

Items (b) through (e), inclusive, shall be required only to the extent that such information is not included in the information provided pursuant to item 1 above. “Obligated Person” means any person who, or entity which, at the time is obligated, directly or indirectly, by contract, generally or through an enterprise fund or account, to make payments in the current or any succeeding Fiscal Year to be applied to pay at least 10% of the aggregate amount of principal of and interest scheduled to become due in such year on the Bonds. There currently are no Obligated Persons.

The District agrees to provide or cause to be provided, in a timely manner, to the MSRB notice of its failure to provide the annual financial information described above on or prior to the date set forth above.

The District further agrees to provide or cause to be provided in a timely manner, either directly or through a designated agent (not in excess of 10 business days after the occurrence of the event), to the MSRB notice of the occurrence of any of the following events with respect to the Bonds:

- ◆ Principal and interest payment delinquencies;
- ◆ Nonpayment related defaults, if material;
- ◆ Unscheduled draws on debt service reserves reflecting financial difficulties;
- ◆ Substitution of credit or liquidity providers, or their failure to perform;
- ◆ Unscheduled draws on credit enhancements reflecting financial difficulties;
- ◆ 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 bondholders, if material;
- ◆ Bond calls (other than scheduled mandatory redemptions of Term Bonds of the Bonds), if material, and tender offers;
- ◆ Defeasances;



- ◆ Rating changes;
- ◆ Release, substitution or sale of property securing repayment of the Bonds, if material;
- ◆ 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 Obligated Person or the sale of all or substantially all of the assets of the District or Obligated Person 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’s obligations to provide annual financial information and notices of material events shall terminate upon the legal defeasance, prior redemption or payment in full of all of the Bonds. Such undertaking, or any provision thereof, shall be null and void if the District (1) obtains an opinion of nationally recognized bond counsel to the effect that those portions of the Rule which require this undertaking, or any such provision, are invalid, have been repealed retroactively or otherwise do not apply to the Bonds; and (2) notifies the MSRB of such opinion and the cancellation of such undertaking.

Notwithstanding any other provision of the Bond Resolution, the District may amend this undertaking and any part of this undertaking may be waived with an approving legal opinion of bond counsel. In the event of any amendment or waiver of a provision of this undertaking, the District shall describe such amendment in the next annual report, and shall include, as applicable, a narrative explanation of the reason for the amendment or waiver and its impact on the type (or in the case of a change of accounting principles, on the presentation) of financial information or operating data being presented by the District. In addition, if the amendment relates to the accounting principles to be followed in preparing financial statements, (1) notice of such change will be given in the same manner as for a material event, and (2) the annual report for the year in which the change is made should present a comparison (in narrative form and also, if feasible, in quantitative form) between the financial statements as prepared on the basis of the new accounting principles and those prepared on the basis of the former accounting principles.

A Bondowner’s or Beneficial Owner’s right to enforce the provisions of the District’s undertaking described in this section shall be limited to a right to obtain specific enforcement of the District’s obligations, and any failure by the District to comply with the provisions of this undertaking shall not be an Event of Default with respect to the Bonds. For purposes of this section, “Beneficial Owner” means any person who has the power, directly or indirectly, to vote or consent with respect to, or to dispose of ownership of, any Bonds, including persons holding Bonds through nominees or depositories.

#### **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. The District filed its 2013 annual financial statements and certain operating information on September 24, 2014 (in a timely manner); however, after filing such information, it was discovered that some operating tables were not included. On October 6, 2014, the District amended the filing to include all relevant information. In addition, it was discovered that the District filed most insurer rating downgrades applicable to bonds that were outstanding at the time of the downgrades, but did not file notice of the Assured downgrade in November 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.

#### **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.

## APPENDIX A

### SUMMARY OF CERTAIN PROVISIONS OF THE BOND RESOLUTION

The following summary is a brief outline of certain provisions of the Bond Resolution and 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 in such Fiscal Year to pay: (a) the interest due in such Fiscal Year on all Parity Bonds then outstanding, excluding interest to be paid from the proceeds of sale of Parity Bonds; (b) the principal of all outstanding Serial Bonds due in such Fiscal Year; and (c) the Sinking Fund Requirement, if any, for any Term Bonds for such Fiscal Year reduced by certain credits made for Term Bonds.

With the consent of the appropriate percentage of Outstanding Parity Bond owners, the District may pass a supplemental resolution supplementing the Bond Resolution for the purpose of providing that in calculating the Annual Debt Service, the District may exclude the direct payment the District is expected to receive in respect of the 2010 Priest Rapids Project Bonds and the 2012 Priest Rapids Project Bonds or other 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. The owners of the 2012 Priest Rapids Project Bonds, the 2013 Priest Rapids Project Bonds and the Bonds are deemed to have consented to this provision.

“Bonds” means the Priest Rapids Hydroelectric Project Revenue and Refunding Bonds, 2014 Series A and Series B (AMT), authorized by the Bond Resolution.

“Coverage Requirement” means (a) 1.15 times the Annual Debt Service in a Fiscal Year, plus (b) any money required by the Bond Resolution to be deposited into the Reserve Account in the Bond Fund or paid to providers of Qualified Insurance obtained for the Reserve Account, less (c) any amounts transferred into the Bond Fund as surplus money as of the end of the preceding Fiscal Year pursuant to the Bond Resolution

“Current Power Sales Contracts” means the contracts entered into in December 2001, between the District and other electric utilities for the sale of power and energy from the Priest Rapids Project, as such contracts may be supplemented and amended from time to time. In this Official Statement, the Current Power Sales Contracts are referred to as the Power Sales Contracts.

“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 Net Revenues on an equal and ratable basis with the outstanding 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 regularly scheduled 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, telecommunications 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, transmission and distribution facilities which heretofore have been or hereafter 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 are 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. The Electric System does not include any interest of the District in the Power Sales Contracts, but does include the right of the District to receive power and energy from the Priest Rapids Project.

“Fiscal Year” means the fiscal year used by the District at any time. At the time of adoption of the Bond Resolution, the Fiscal Year is the 12 month period beginning January 1 of each year.

“Future Parity Bonds” means any bonds of the District issued in accordance with the Bond Resolution after the date of issuance of the Bonds and that are secured by a lien and charge as described in the Bond Resolution equal to the lien and charge securing the payment of the principal of and interest on the Outstanding Parity Bonds and the Bonds.

“Government Obligations” means those obligations defined in chapter 39.53 RCW, as amended.

“Gross Revenues” means all income, revenues, receipts and profits derived by the District through the ownership and operation of the Priest Rapids Project, 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 Priest Rapids Project, 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 Priest Rapids Project, exclusive of insurance proceeds and 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 Parity Bonds defeased pursuant to the Bond Resolution or other bonds defeased, or the payment of which is provided for, under any similar provision of any other bond resolutions of the District, and exclusive of investment income earned on money in any arbitrage rebate fund established for any Parity Bonds.

“Junior Lien Bond” means the Priest Rapids Hydroelectric Project Junior Lien Revenue Bond, 2014 (Taxable).

“Junior Lien Bond Fund” means the fund created pursuant to the Bond Resolution to pay the principal of and interest on the Junior Lien Bond.

“Net Revenues” means, for any period, the excess of Gross Revenues over Operating Expenses for such period, excluding from the computation of Gross Revenues 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 Priest Rapids Project, or resulting from the early extinguishment of debt.

“Operating Expenses” means the District’s expenses for operation and maintenance of the Priest Rapids Project, and ordinary repairs, renewals of and replacements to the Priest Rapids Project, including payments into working capital 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, 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 Priest Rapids Project; 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 or any allowance for depreciation.

“Outstanding” when used with respect to Parity Bonds means, as of any date, Parity Bonds theretofore or thereupon issued pursuant to a resolution of the Board except (i) any Parity Bonds canceled by the Registrar or paid at or prior to such date, (ii) Parity Bonds in lieu of or in substitution for which Parity Bonds have been delivered, and (iii) Parity Bonds deemed no longer outstanding under the resolution authorizing their issuance.

“Outstanding Parity Bonds” means the Outstanding Priest Rapids Bonds, the Outstanding Wanapum Bonds and the Outstanding Priest Rapids Project Bonds.

“Outstanding Priest Rapids Bonds” means the currently Outstanding 2003 Priest Rapids Bonds, 2005 Priest Rapids Bonds and 2006 Priest Rapids Bonds.

“Outstanding Priest Rapids Project Bonds” means the currently Outstanding 2010 Priest Rapids Project Bonds, 2012 Priest Rapids Project Bonds and 2013 Priest Rapids Project Bonds.

“Outstanding Wanapum Bonds” means the currently Outstanding 2003 Wanapum Bonds, 2005 Wanapum Bonds and 2006 Wanapum Bonds.

“Paying Agent” means the designated fiscal agent of the State of Washington or any bank or banks designated a Paying Agent by the District.

“Permitted Investments” means the following to the extent the same are legal for investments of funds of the District: (a) any bonds or other obligations which as to principal and interest constitute direct obligations of, or are unconditionally guaranteed by, the United States, including obligations of any of the federal agencies set forth in clause (b) below to the extent unconditionally guaranteed by the United States; (b) obligations of the Export-Import Bank of the United States, the Government National Mortgage Association, the Federal National Mortgage Association to the extent guaranteed by the Government National Mortgage Association, the Farmers Home Administration, or any agency or instrumentality of the Federal Government which shall be established for the purposes of acquiring the obligations of any of the foregoing or otherwise providing financing therefor; (c) new housing authority bonds issued by the public agencies or municipalities and fully secured as to the payment of both principal and interest by a pledge of annual contributions under an annual contributions contract or contracts with the United States, or project notes issued by public agencies or municipalities and fully secured as to the payment of both principal and interest by a requisition or payment agreement with the United States; (d) direct and general obligations of any State within the territorial United States, to the payment of the principal of and interest on which the full faith and credit of such State is pledged, provided, that at the time of their purchase, such obligations are rated in one of the two highest rating categories by either Moody’s Investors Service or Standard & Poor’s Ratings Services or their comparably recognized business successors or both Moody’s Investors Service and Standard & Poor’s Ratings Services or their comparably recognized business successors if such obligations are rated by both; (e) certificates of deposit, whether negotiable or nonnegotiable, issued by any bank, savings and loan association or trust company provided that such certificates of deposit shall be (i) continuously and fully insured by the Federal Deposit Insurance Corporation, or (ii) issued by a recognized qualified public depository of the State of Washington under chapter 39.58 RCW, as amended, or (iii) continuously and fully secured by such securities as are described above in clauses (a) or (b), which shall have a market value (exclusive of accrued interest) at all times at least equal to the principal amount of such certificates of deposit; (f) any repurchase agreement with any bank or trust company organized under the laws of any State of the United States or any national banking association, which is secured by such securities as described in clauses (a) or (b) above in the possession or custody of the District or its agent and in which the District or its agent has a first perfected security interest free and clear of all rights of third parties, which

matures within 270 days and which has a market value determined monthly equal to 100% of the face amount of the repurchase agreement; (g) Refunded Municipals (as defined in the Bond Resolution); and (h) any other investments or investment agreements permitted under the laws of the State of Washington, as amended from time to time.

“Power Sales Contracts” means the Current Power Sales Contracts and any other contracts entered into by the District for the sale of power and energy from the Priest Rapids Project, and as such contracts may be amended and supplemented from time to time.

“Project Account” means the account of the District authorized to be created to pay costs of improvements to the Priest Rapids Project financed by proceeds of the Bonds and the Junior Lien Bond.

“Qualified Insurance” means any 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 currently rated in the highest rating category (one of the two highest categories if the conditions set forth in the Bond Resolution are met) by Moody’s Investors Service or Standard & Poor’s or their comparably recognized business successors or both Moody’s Investors Service and Standard & Poor’s or their comparably recognized business successors if such institution is rated by both.

“Qualified Letter of Credit” means any letter of credit issued by a financial institution for the account of the District on behalf of the owners of a series of the 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 currently rated in the highest rating category (one of the two highest categories if the conditions set forth in Bond Resolution are met) by Moody’s Investors Service or Standard & Poor’s or their comparably recognized business successors or both Moody’s Investors Service and Standard & Poor’s or their comparably recognized business successors if such institution is rated by both.

“RR&C Fund” means the Priest Rapids Project Repair, Renewal and Contingency Fund created by Resolution No. 8475.

“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.

“Registrar” means the registrar and authenticating agent appointed pursuant to the Bond Resolution, its successor or successors and any other entity which may at any time be substituted in its place pursuant to the Bond Resolution.

“Reserve Account Requirement” means (a) with respect to the Bonds and each issue of Outstanding Parity Bonds, the maximum amount of interest due in any Fiscal Year on such Parity Bonds computed as of the date of Closing of such issue, (b) with respect to all Bonds and Outstanding Parity Bonds then Outstanding, the sum of all amounts computed under (a) above and (c) with respect to an issue of Future Parity Bonds, the amount set forth in the resolution authorizing such Future Parity Bonds; provided, however, that so long as any 2005 Priest Rapids Bonds or 2005 Wanapum Bonds are insured under a policy issued by FGIC and such insurer is not in default thereunder or so long as any 2006 Priest Rapids Bonds or 2006 Wanapum Bonds are insured under a policy issued by MBIA Insurance Corporation and such insurer is not in default thereunder, the Reserve Account Requirement with respect to any Future Parity Bonds secured by the Reserve Account shall be an amount equal to the maximum amount of interest due in any Fiscal Year on such Future Parity Bonds. The resolution authorizing Future Parity Bonds may establish a separate reserve account for any such Future Parity Bonds or provide that some or all of such Future Parity Bonds be secured by a common reserve account. In the case of Variable Interest Rate Bonds, the interest rate thereon shall be calculated on the assumption that such Bonds will bear interest at a rate equal to the rate most recently reported by The Bond Buyer as The Bond Buyer’s index for long-term revenue bonds; provided that if on such date of calculation the interest rate on such Parity Bonds shall then be fixed to maturity, the interest rate used for such specified period for the purpose of the foregoing calculation shall be such actual interest rate.

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

“Sinking Fund Requirement” means, for any Fiscal Year, the principal amount and premium, if any, of Term Bonds required to be purchased, redeemed or paid at maturity for such Fiscal Year as established by the resolution of the District authorizing the issuance of such Term Bonds.

“Term Bonds” means Parity Bonds of any principal maturity that are subject to mandatory redemption or for which mandatory sinking fund payments are required.

“Trustee” means through December 31, 2014, The Bank of New York Mellon Trust Company, N.A.

“2003 Priest Rapids Bonds” means the \$18,450,000 principal amount of Priest Rapids Hydroelectric Development Second Series Revenue Bonds, 2003 Series Z authorized by Resolution No. 7603.

“2003 Wanapum Bonds” means the \$20,135,000 principal amount of Wanapum Hydroelectric Development Second Series Revenue Bonds, 2003 Series Z, authorized by Resolution No. 7604.

“2005 Priest Rapids Bonds” means the \$139,515,000 principal amount of Priest Rapids Hydroelectric Development Revenue and Refunding Bonds, 2005 Series A, B and Z authorized by Resolution No. 7901.

“2005 Wanapum Bonds” means the \$127,780,000 principal amount of Wanapum Hydroelectric Development Revenue and Refunding Bonds, 2005 Series A, B and Z, authorized by Resolution No. 7777.

“2006 Priest Rapids Bonds” means the \$66,610,000 principal amount of Priest Rapids Hydroelectric Development Revenue and Refunding Bonds, 2006 Series A, B and Z authorized by Resolution No. 8056.

“2006 Wanapum Bonds” means the \$186,430,000 principal amount of Wanapum Hydroelectric Development Revenue and Refunding Bonds, 2006 Series A, B and Z, authorized by Resolution No. 8057.

“2010 Priest Rapids Project Bonds” means the \$349,430,000 principal amount of Priest Rapids Hydroelectric Project Revenue and Refunding Bonds, 2010 Series A, B, L, M and Z authorized by Resolution No. 8475.

“2012 Priest Rapids Project Bonds” means the \$127,620,000 principal amount of Priest Rapids Hydroelectric Project Revenue and Refunding Bonds, 2012 Series A, B, M and Z authorized by Resolution No. 8625.

“2013 Priest Rapids Project Bonds” means the \$100,070,000 principal amount of Priest Rapids Hydroelectric Project Revenue Bonds, 2013 Series A and Z authorized by Resolution No. 8681.

## **Revenue Fund**

The District shall pay into the Priest Rapids Project Revenue Fund all Gross Revenues, exclusive of earnings on money in the RR&C Fund, Project Fund and the Bond Fund. The District shall pay from the Revenue Fund, after paying or making provision for the payment of Operating Expenses, the Coverage Requirement. On or prior to the 25th day of each month, the Coverage Requirement shall be disbursed as follows:

- (A) The payments into the Bond Fund required by the Bond Resolution.
- (B) The deposits into the Reserve Account or payments to a provider of Qualified Insurance obtained to satisfy the Reserve Account Requirement required by the Bond Resolution.
- (C) An amount equal to .0125 of Annual Debt Service shall be deposited into the RR&C Fund and applied to the purposes set forth in the Bond Resolution.

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

- (1) to pay or provide for Operating Expenses;
- (2) to make all payments required to be made into the Interest Account and to make any District Payments;
- (3) to make all payments required to be made into the Principal and Bond Retirement Account;
- (4) to make all payments required to be made into the Reserve Account and to make all payments required to be made pursuant to a reimbursement agreement or agreements (or other equivalent documents) in connection with Qualified Insurance or a Qualified Letter of Credit obtained for the Reserve Account; provided that if there is not sufficient money to make all payments under such reimbursement agreements, the payments will be made on a pro rata basis;
- (5) to make all payments required to be made into the RR&C Fund; and
- (6) to make all payments required to be made into any special fund or account created, including the Junior Lien Bond Fund, to pay or secure the payment of junior lien obligations, including the Junior Lien Bond.

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 relating to the Priest Rapids Project.

### **Bond Fund**

The Priest Rapids Project Bond Fund (the "Bond Fund") shall be held in trust and administered by the District and consists of three accounts: the Interest Account, the Principal and Bond Retirement Account and the Reserve Account. The Bond Fund shall be used to pay the principal of, premium, if any, and interest on the Parity Bonds, and for purchasing such bonds prior to maturity. District Payments shall be made from, and Reciprocal Payments shall be made into, the Interest Account. The Bank of New York Mellon Trust Company, N.A. is appointed to act as Trustee and hold the Interest Account and the Principal and Bond Retirement Account through December 31, 2014. As of January 1, 2015, the District will hold the Interest Account and the Principal and Bond Retirement Account in lieu of having the Trustee hold the accounts, and there will be no Trustee. The District will hold the Reserve Account. The District obligates and binds itself irrevocably to pay into the following accounts in the Bond Fund out of Gross Revenues certain fixed amounts in the following order of priority:

- (1) Interest Account: On or prior to each date interest on the Parity Bonds becomes due, the amount, which (together with funds available in such account) shall equal the installment of interest next falling due on all Parity Bonds then Outstanding;
- (2) Principal and Bond Retirement Account: On or prior to each date principal or a Sinking Fund Requirement is due, the amount which (together with funds available in such account) shall equal the installment of principal next falling due on all Parity Bonds then Outstanding or the Sinking Fund Requirement next falling due. The Trustee or District, as applicable, shall apply the money in the Principal and Bond Retirement Account to the redemption or purchase of Term Bonds on the next ensuing Sinking Fund Requirement due date; and
- (3) Reserve Account: On or before the 25th day of each of the six months next succeeding each date of valuation of the amount in the Reserve Account, 1/6th of the amount necessary to make the valuation of the amount in the Reserve Account equal to the Reserve Account Requirement, if the valuation of the amount in the Reserve Account is less than the Reserve Account Requirement. Such amounts will be withdrawn from the Revenue Fund, the RR&C Fund or the construction funds. The District may obtain Qualified Insurance or a Qualified Letter of Credit for specific amounts required to be paid out of the Reserve Account.

The valuation of the amount in the Reserve Account must be made by the District on each December 31 and after certain withdrawals and may be made on each June 30. If the valuation of the amount in the Reserve Account is greater than the Reserve Account Requirement, then and only then may the District withdraw at any time prior to the



next date of valuation from the Reserve Account the difference between the amount of the valuation and the Reserve Account Requirement.

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, prior to the final installment of principal of the Parity Bonds.

The Trustee or the District, as applicable, shall make up any deficiency in the Interest Account or the Principal and Bond Retirement Account from the funds available in the Reserve Account. See “SECURITY FOR THE PARITY BONDS—Reserve Account—Reserve Account Surety Bonds.”

### **Project Account**

The Bond Resolution creates a Project Account. A portion of the proceeds of the Bonds and the Junior Lien Bond will be deposited into the Project Account and applied to pay costs of improvements to the Priest Rapids Project and to pay costs of issuance of the Bonds and the Junior Lien Bond.

### **Supplemental Repair and Renewal Fund**

The 1986 Bond Resolutions created the Priest Rapids Development Supplemental Repair and Renewal Fund and the Wanapum Supplemental Renewal and Contingency Fund. Resolution No. 8475 combined such funds into the RR&C Fund. The amount in such Fund was initially \$12,000,000 (the “Supplemental Fund Cap”). The amount in such Fund shall not exceed the Supplemental Fund Cap as of the last day of any Fiscal Year. The District may increase or decrease the amount of the Supplemental Fund Cap by resolution of the Commission. Earnings on investments in the RR&C Fund shall be transferred to the Revenue Fund to the extent not required to maintain the Supplemental Fund Cap. If money in the RR&C Fund at the end of any Fiscal Year, after making transfers into the Revenue Fund as provided in the preceding sentence, exceeds the Supplemental Fund Cap, such excess shall be transferred to the Bond Fund.

Money in the RR&C Fund must be used to make up any deficiency in the Bond Fund. To the extent not required to make up any deficiency in the Bond Fund, money in the RR&C Fund may be applied to any one or more of the following purposes: (1) to pay the cost of any project of repair, renewal, replacement, extraordinary maintenance, and safety improvement for the Priest Rapids Project; (2) to pay the cost of other improvements to and extensions of the Priest Rapids Project, including planning and design and feasibility studies for such improvements and extensions; and (3) to pay extraordinary operation costs.

### **Additional Parity Bonds**

Future Parity Bonds may be issued for any lawful purpose of the District relating to the Priest Rapids Project, including, but not limited to, acquiring, constructing and installing additions, betterments and improvements to and extensions of, acquiring necessary equipment for, or making necessary renewals, replacements or repairs and capital improvements to the Priest Rapids Project, refunding any outstanding indebtedness, and funding the RR&C Fund. The District must comply with the following conditions before issuing additional Parity Bonds:

(1) At the times of the issuance of such Future Parity Bonds there is no deficiency in the Bond Fund or in any accounts therein.

(2) If such additional Parity Bonds are being issued to pay costs other than refunding Parity Bonds, there shall have been delivered to the District a report of a Professional Utility Consultant to the effect that (a) the plan pursuant to which proceeds of such Parity Bonds are to be expended is consistent with prudent utility practice and will not materially adversely interfere with operation of the Priest Rapids Project, and (b) in the opinion of the Professional Utility Consultant, based upon such assumptions as he believes to be reasonable, such plan will not result in a reduction of the Net Revenues below the amounts covenanted in the rate covenant in the Bond Resolution to be maintained; provided, however, that once the 2001 Priest Rapids and Wanapum Bonds are no longer Outstanding, no such report of a Professional Utility Consultant will be required where contracts with the Electric

System (which may include a resolution of the District with respect to such obligation of the Electric System) and/or other purchasers are in effect for a term at least as long as the term of the proposed Future Parity Bonds and require the Electric System and/or other purchasers to purchase 100% of the power from and to pay 100% of the costs of the Priest Rapids Project, including the cost of maintaining the rate coverage requirements of the Bond Resolution.

(3) The resolution authorizing the issuance of the additional Parity Bonds shall require that there shall be paid into the Reserve Account in the Bond Fund (a) from the proceeds of such Future Parity Bonds an amount such that the amount on deposit in the Reserve Account is equal to the Reserve Account Requirement, or (b) from Gross Revenues (i) in not more than five equal annual installments commencing one year from the date of issuance of such Future Parity Bonds or (ii) on the date of issuance of such Future Parity Bonds, or so long as any 2005 Priest Rapids and Wanapum Bonds are insured under a policy issued by Financial Guaranty and such insurer is not in default thereunder, an amount such that the amount on deposit in the Reserve Account is equal to the applicable Reserve Account Requirement, or (c) by the deposit of a Qualified Letter of Credit or Qualified Insurance the face amount of which, together with other funds on deposit in the Reserve Account, is equal to the Reserve Account Requirement. Upon the issuance of any Future Parity Bonds, the District shall recalculate the Reserve Account Requirement.

If any Future Parity Bonds are issued for refunding purposes and the issuance of such refunding Parity Bonds results in a present value monetary saving to the District and such refunding Parity Bonds will not require a greater amount (exclusive of issuance costs, any call premiums, and 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 Annual Debt Service on the bonds being refunded, then subsection 2 above need not be complied with.

#### *Junior Lien Bonds*

The District may issue bonds, notes, warrants or other obligations payable from and secured by a lien and charge junior to the lien and charge of the Parity Bonds. The Junior Lien Bond is a junior lien obligation. The District may issue bonds, notes, warrants or other obligations payable from and secured by a lien and charge equal or junior to the lien and charge of the Junior Lien Bond.

#### **Derivative Products**

To the extent permitted by state law the District may enter into Derivative Products on a parity with the Bonds and 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. District Payments shall be made from the Bond Account, and Annual Debt Service shall include any regularly scheduled District Payments adjusted by any regularly scheduled Reciprocal Payments. Reciprocal Payments shall be deposited into the Bond Account. 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 Parity Bonds then Outstanding.

(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.

## **Covenants**

### *Rate Covenant—General*

The District shall establish, maintain and collect rates or charges in connection with the ownership and operation of the Priest Rapids Project that shall be fair and nondiscriminatory and adequate to provide Gross Revenues sufficient for the payment of the principal of and interest on all Outstanding Parity Bonds, all amounts which the District is obligated to set aside in the Bond Fund, the payment of all Operating Expenses of the Priest Rapids Project, and for the payment of any and all amounts that the District may now or hereafter become obligated to pay from said Gross Revenues. See “SECURITY FOR THE PARITY BONDS – Rate Covenants.”

### *Rate Covenant—Debt Service Coverage*

The District shall establish, maintain and collect rates or charges in connection with the ownership and operation of the Priest Rapids Project sufficient to provide Net Revenues in any Fiscal Year hereafter in an amount at least equal to the Coverage Requirement, and any amounts required to pay the principal of and interest on any junior lien obligations, excluding any capitalized interest. See “SECURITY FOR THE PARITY BONDS – Rate Covenants.”

### *Tax Covenant*

The District has covenanted to undertake all actions required to maintain the tax-exempt status of interest on the 2014A Bonds and 2014B Bonds under Section 103 of the Code, including the payment of arbitrage rebate, if necessary, as set forth in the Tax Certificate.

### *FERC License*

The District will use its best efforts to retain the FERC license for the Priest Rapids Project and renew such FERC license when it expires.

### *Enforcement of Power Sales Contracts*

The District has covenanted to enforce its rights and the obligations of power purchasers under the Power Sales Contracts.

## **Additional Covenants**

### *Obligation of the Electric System*

Payments made by the Electric System for the costs of purchased power and energy shall be an operating expense of the Electric System. See “SECURITY FOR THE PARITY BONDS—Obligations of the Electric System” for a description of the Electric System’s obligations.

### *Maintenance of Developments in Good Condition*

The District will maintain, preserve and keep the Priest Rapids Project 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.

#### *Disposal of Properties*

The District will not sell or otherwise dispose of the Priest Rapids Project in its entirety unless simultaneously with such sale or other disposition, provision is made for the payment into the Bond Fund sufficient to pay the principal of and interest on all Parity Bonds then Outstanding and any premium upon the retirement thereof in full, nor will it sell or otherwise dispose of any part of the useful operating properties of the Priest Rapids Project if such sale or disposition would result in a reduction of Net Revenues below the amounts required in the Bond Resolution.

The District may sell or otherwise dispose of any of the properties of the Priest Rapids Project which shall have become unserviceable, inadequate, obsolete or unfit to be used in the operation of the Priest Rapids Project or no longer necessary, material to or useful in such operation.

#### *Insurance*

The District will keep the Priest Rapids Project 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 the District may, if deemed necessary and advisable by the Commission, institute or continue a self insurance program with respect to such risks. In the event of any loss or damage, the District will promptly deposit the insurance proceeds into any construction funds, and use such funds to repair or replace the damaged portion of the insured property; or in the event the District should determine not to repair or reconstruct such damaged portion, the proceeds of such insurance or self insurance funding shall be transferred to the Reserve Account to the extent necessary to make up any deficiency in the Reserve Account and the balance, if any, shall, at the option of the District, be used for repairs, renewals, replacements, or additions to or extensions of the Priest Rapids Project or be used in the retirement of Parity Bonds prior to maturity, either by purchase or by call for redemption.

#### *Books of Account*

The District shall keep proper books of account, showing as a separate utility system the accounts of the Priest Rapids Project, in accordance with the rules prescribed by the Division of Municipal Corporations of the Washington State Auditor's office, or other State agency succeeding to such duties, and 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. The District shall cause its books of account to be audited annually by the State Auditor's office or other State agency authorized by law to make such audits, or if such an audit shall not be made for 12 months after the close of any Fiscal Year, by independent certified public accountants. Any owner of any Bond may obtain at the office of the District copies of the balance sheet and statement of income and retained earnings showing in reasonable detail the financial condition of the Priest Rapids Project, as a segment of the audited financial statements of the District, as of the close of each Fiscal Year, and the income and expenses of such year, including the amounts paid into the funds created pursuant to the Bond Resolution, and the amounts expended for maintenance, renewals, replacements, and gross capital additions to the Priest Rapids Project.

#### *Make Only Economically Sound Improvements*

The District will not expend any revenues from the Priest Rapids Project or proceeds of Parity Bonds or other obligations for any extensions, betterments and improvements to the Priest Rapids Project which will not properly and advantageously contribute to the business of the Priest Rapids Project.

#### *Merger or Consolidation*

The District shall use its best efforts to avoid dissolution, termination of its existence or consolidation with another entity, without paying or providing for the payment of all Parity Bonds then Outstanding.

## **Rebates To Purchasers**

If required by contract with the purchasers of power and energy from the Priest Rapids Project, the District may rebate money on hand in any fund, except the Bond Fund, relating to the Priest Rapids Project to such purchasers. Such a rebate may be paid to the Electric System on the same basis as to the other purchasers.

## **Events Of Default, Bondowners' Trustee, Remedies**

### *Events of Default*

The following constitute "Events of Default" under the Bond Resolution:

- (1) Default in the due and punctual payment of the principal of any of the Parity Bonds when the same shall become due, either at maturity or following notice of redemption;
- (2) Default in the due and punctual payment of interest on any Parity Bond when the same shall become due and payable;
- (3) Failure to purchase or redeem Term Bonds in an aggregate principal amount at least equal to the Sinking Fund Requirement for the applicable Fiscal Year;
- (4) Defaults in the performance of any other of the covenants, conditions and agreements in the Bond Resolution and such default continues for 90 days after the District receives from the Trustee or from the owners of not less than 66% in principal amount of any series of Parity Bonds then Outstanding, a written notice demanding the cure of such default; or
- (5) If the District: (a) admits in writing its inability to pay its debts generally as they become due; (b) files a petition in bankruptcy or seeking a composition of indebtedness under any state or federal law; (c) makes an assignment for the benefit of its creditors; (d) consents to the appointment of a receiver of the whole or any substantial part of the Priest Rapids Project; or (e) consents to the assumption by any court of competent jurisdiction under any other law for the relief or aid of debtors of custody or control of the District or of the whole or any substantial part of the Priest Rapids Project.

### *Bondowners' Trustee*

If an Event of Default has occurred, is continuing, and has not been remedied, the owners of 25% in principal amount of Parity Bonds then outstanding, may appoint a bondowners' trustee (the "Bondowners' Trustee") by an instrument or concurrent instruments in writing signed and acknowledged by such registered owners of the Parity Bonds duly authorized and delivered to such Bondowners' Trustee, notification thereof being given to the District. Any Bondowners' Trustee so appointed must be a bank or trust company organized under the laws of the State of New York or a national banking association. That appointment shall become effective immediately upon acceptance thereof by the Bondowners' Trustee. The bank or trust company acting as 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 then 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 appointed in the manner provided in the Bond Resolution, and each successor thereto, will be a trustee for the owners of all Parity Bonds outstanding and is empowered to exercise all the rights and powers conferred on the Bondowners' Trustee. 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 then Outstanding; provided, however, that no such resignation or removal can be effective until the successor Bondowners' Trustee has been appointed.

Any money collected by the Bondowners' Trustee at any time shall be applied in the following order of priority:

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

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 (other than Parity Bonds previously called for redemption for the payment of which money is held pursuant to the provisions of the Bond Resolution), 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; and (ii) a Bondowners' Trustee has been appointed; and (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; and (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; and (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.

No registered owner or beneficial owner of any Parity Bond shall have any right in any manner whatever by his action to affect or impair the obligation of the District to pay from the Net Revenue the principal of and interest on such Parity Bonds to the respective owners thereof when due.

### **Amendments**

Without the consent of the owners of Parity Bonds, the District may adopt supplemental resolutions to add to the covenants of the District contained in, or to surrender any right reserved to or conferred upon it by, the Bond Resolution, or to cure any ambiguity or correct any defect in the Bond Resolution or to change or add any provision to the Bond Resolution which will not materially adversely affect the bondowners in the opinion of nationally recognized bond counsel.

Any amendments or supplements to the Bond Resolution may be made by the District with the consent of 66% in aggregate principal amount of the Parity Bonds then outstanding; provided that without the consent of the owner of each Parity Bond that would be affected, no supplemental resolution shall (1) change the fixed maturity date for the payment of the principal of any Parity Bond or the date for the payment of interest thereon or the terms of the redemption thereof, or reduce the principal amount of any Parity Bond or the rate of interest thereon or the redemption price (or the redemption premium) payable upon the redemption or prepayment thereof; (2) reduce the aforesaid percentage of Parity Bonds the owners of which are required to consent to any supplemental resolution; (3) give to any Parity Bond any preference over any other Parity Bond; (4) create any pledge of the Gross Revenues and other money pledged superior or equal to the pledge of and lien and charge for the payment of the Parity Bonds; or (5) deprive any owner of the Bonds of the security afforded by the Bond Resolution.

After the owners of the required percentage of Parity Bonds have filed their consents to an amending or supplementing resolution, the District may thereafter adopt such amending or supplementing resolution. Notice of any such amendment or supplement must be given to each registered owner of Parity Bonds then Outstanding. Any action or proceeding to set aside or invalidate any such amending or supplementing resolution or any of the proceedings for its adoption must be commenced within 60 days after the mailing of such notice.

### **Rights of Insurers**

For all purposes of governing events of default and remedies, except the giving of notice of default to registered owners of the Outstanding Parity Bonds, the insurer of Parity Bonds shall be deemed to be the sole holder of the

bonds it has insured for so long as it has not failed to comply with its payment obligations under the policy. Any amendment or supplement to the Bond Resolution shall be subject to the prior written consent of certain Insurers.

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## APPENDIX B

### SUMMARY OF CERTAIN PROVISIONS OF THE PRIEST RAPIDS PROJECT POWER SALES CONTRACTS

In 2001-02, the District executed power sales contracts for the output from the Priest Rapids and Wanapum Developments (together the “Priest Rapids Project”) with the District’s twelve original purchasers, four Idaho cooperatives and one association of cooperatives located in Idaho. Since the contracts were signed, additional amendments have been executed (as amended, the “Power Sales Contracts”). The Power Sales Contracts went into effect on November 1, 2005, with respect to power from the Priest Rapids Development, and on November 1, 2009, with respect to power from the Wanapum Development.

The Power Sales Contracts consist of a series of agreements signed with each of the Power Purchasers. The term of the Power Sales Contracts is for the term of the new license received by the District for the Priest Rapids Project (44 years). Since the signing of the Power Sales Contracts, the four small original purchasers and all of the Idaho entities have entered into Exchange Agreements whereby they exchanged the series of agreements for one agreement with a fixed purchaser share.

Summaries of certain provisions of the Power Sales Contracts are set forth below. Reference is made to the complete text of the Power Sales Contracts for all of the provisions thereof. The major provisions of each of the Power Sales Contracts are substantially similar except as to the percentages of Priest Rapids Project Output to be taken by each of the Power Purchasers.

Term: Effective November 1, 2005 for the Priest Rapids Development and November 1, 2009 for the Wanapum Development, the District has available for its own use and for sale to others 100% of the output of the Priest Rapids Project.

Priest Rapids Project Output. The Priest Rapids Project Output is defined as the amount of power and energy produced by, or received for the account of, the Priest Rapids Project during the term of the Power Sales Contracts under the operating conditions which exist during said term, including periods when the Priest Rapids Project may be inoperable, after corrections for encroachment, station and Priest Rapids Project use, and depletions required by the FERC License.

Product Sales Contracts (as amended). The Product Sales Contracts address the 70% of output from the Priest Rapids Project that is not reserved by the FERC for sale to power customers in the region, as required by PL-544. Of that 70% of output from the Priest Rapids Project, each of the Power Purchasers receives, at cost, its participating share of the output (firm and non-firm) that remains after the District has satisfied its requirements. As the District’s load requirements increase, the amount of power available to the Power Purchasers under the Product Sales Contracts will decrease. The District’s share is calculated on the basis of 70% of the Priest Rapids Project; however, the maximum it can actually receive is 63.3% of the output from the Priest Rapids Project due to the elimination of the “Additional Product Sales Contract” via an amendment to the Product Sales Contracts and the execution of the Exchange Agreements. The Power Purchasers receive, at a minimum, the remaining 6.7% slice. The District provides the Power Purchasers with an annual forecast of its requirements.

Reasonable Portion Power Sales Contracts (as amended). The Reasonable Portion Power Sales Contracts (Reasonable Portion Contracts) address proceeds from the sale of and the associated Project related costs of the 30% of output from the Priest Rapids Project (the “reasonable portion”) that is reserved by the FERC for sale to power entities in the region, as required by PL-544. The FERC order requires that this power be sold according to market based principles while giving preference to the District preference customers (its Power Purchasers). The District executed with the purchasers the Reasonable Portion Contracts which provides them proportionate shares of the proceeds from the sale of the reasonable portion and requires them to pay the same proportionate share of the reasonable portion costs. Once the District has taken its maximum amount of power allowed under the Product Sales Contracts, the Reasonable Portion Contracts provides the District the right to revenues from the sale of the reasonable portion and the obligation to pay the associated reasonable portion costs to provide for its remaining firm energy requirements.

Continuity of Payments for Projects and Payments by Power Purchasers. Monthly payments for Priest Rapids Project Output shall be made by the Power Purchasers (and by the District through its Electric System) to the extent the Priest Rapids Project produces or is capable of producing power and energy in a Fiscal Year during the term of the Power Sales Contracts sufficient in aggregate amount to pay all costs of the District resulting from the ownership, operation, maintenance of and improvements to the Priest Rapids Project, including 115% of debt service on Parity Bonds whether or not the Priest Rapids Project is operable; provided, however, that the amounts required to be paid with respect to the Parity Bonds shall include only the amounts required to be paid during the term of the Power Sales Contracts in accordance with the amortization of the Parity Bonds. See “SECURITY FOR THE PARITY BONDS—Obligations of the Electric System.”

The Power Purchasers agree to pay the District their respective percentage shares of all of the District’s costs related to the Priest Rapids Project, including, but not limited to:

(1) All costs of producing and delivering power and energy (excluding depreciation) that are properly chargeable to the Priest Rapids Project in accordance with the Uniform System of Accounts, less any credits against such costs by reason of net revenues from other sources than the direct sale of power, and also less any credits for interest charged during construction, all as provided for in the Uniform System of Accounts;

(2) Amounts required to pay for the prevention or correction of any loss or damage and for major replacements to keep the Priest Rapids Project in good operating condition to the extent that such costs are not covered by insurance and by the RR&C Fund;

(3) Amounts needed to pay debt service on bonds or other obligations financing improvements to the Priest Rapids Project, plus an additional 15% of the amount of debt service for Parity Bonds;

(4) Costs of creating and replenishing any reserve or contingency fund required to be maintained by any bond resolutions and working capital funds;

(5) Liabilities, including settlements and judgments, resulting from ownership, operation or maintenance of the Priest Rapids Project and not covered by insurance;

(6) Costs incurred by the District in applying for a new FERC license for the Priest Rapids Project

(7) Obligations entered into by the District in obtaining a new FERC license for the Priest Rapids Project, including but not limited to the cost of replacing products that may be committed in such obligations;

(8) An amount equal to 15% of debt service in that contract year or such higher amount as may be required by a bond resolution to satisfy the Coverage Requirement.

In addition to the credits described in (1) and (2) above, Power Purchasers will receive credits for the following:

(A) Revenue, if any, received from obligations entered into by the District as part of its relicensing efforts;

(B) The 15% Coverage Requirement amount, to the extent that it is not spent for capital or other costs of the Developments; and

(C) Interest earnings on funds of the Priest Rapids Project that are not required to be retained by such funds pursuant to any of the bond resolutions.

Debt. Regardless of how the District structures debt to pay costs of improvements to the Priest Rapids Project, the Power Purchasers will pay their share of such debt as if it were structured with level debt service amortized over a period equal to the estimated weighted average economic service life of the improvements financed or refinanced by such debt; provided that the amortization period shall not exceed 30 years.

Billing. At least 30 days before each contract year beginning in 2005, the District must give each Power Purchaser a pro forma statement showing estimated annual power costs, the Power Purchaser's estimated cost, and monthly payments for the following contract year. A final accounting shall be rendered to the Power Purchasers by the District by June 1 of each year, and any charge or credit adjustment required shall be made promptly by the District and the Power Purchasers.

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**APPENDIX C**

**AUDITED FINANCIAL STATEMENTS OF THE DISTRICT  
AS OF DECEMBER 31, 2013 AND 2012**

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Public Utility District No. 2 of  
Grant County, Washington  
Financial Statements  
December 31, 2013 and 2012

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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, 2013 and December 31, 2012, 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, 2013 and December 31, 2012, 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.



***Emphasis of Matter***

As discussed in Note 1 to the financial statements, the District adopted the provisions of GASB Statement No. 65, *Items Previously Reported as Assets and Liabilities*, effective January 1, 2013. The financial statements as of and for the year ended December 31, 2012 have been restated for this change. Our opinion is not modified with respect to this matter.

***Other Matters***

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 3 through 10 be presented to supplement the basic financial statements. Such information, although not 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 historic 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 that collectively comprise the District's 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. The information is the responsibility of management and was derived from and relates directly to the underlying account and other records used to prepare the basic financial statements. The information has been subjected to the auditing procedures applied in the audits of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves and other additional procedures, in accordance with auditing standards generally accepted in the United States of America. In our opinion, the Supplemental Disclosures of Telecommunication Activities is fairly stated in all material respects, in relation to the financial statements taken as a whole.

*PricewaterhouseCoopers LLP*

April 28, 2014

# **PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON**

## **MANAGEMENT'S DISCUSSION AND ANALYSIS DECEMBER 31, 2013 AND 2012**

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As of December 31, 2013, 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, 2013, 2012, and 2011. 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 August of 2013, the District issued \$100.1 million of revenue bonds, at a net premium of \$1.2 million, associated with the Priest Rapids Project to finance improvements at the Priest Rapids Project, to pay issuance costs, and to fund a debt service reserve. In September of 2013, the District issued \$67.6 million of revenue refunding bonds, at a net premium of \$815 thousand, associated with the Electric System to refund certain bonds previously issued, to pay issuance costs, and to fund a debt service reserve. This refunding allowed the District to restructure debt service so as to obtain a closer alignment and a more fair allocation between the costs of the electric system assets being financed and the enjoyment of the benefits derived from said assets over their useful lives. The debt

## **PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON**

### **MANAGEMENT'S DISCUSSION AND ANALYSIS DECEMBER 31, 2013 AND 2012**

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restructuring was accompanied by moderate retail electric rate increases into the foreseeable future. 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. The District had revenue bonds outstanding of \$1.15 billion as of December 31, 2013, \$1.08 billion as of December 31, 2012, and \$1.07 billion as of December 31, 2011. See Note 5.

The Commission implemented rate increases to retail customers in February of 2011, January of 2012, January of 2013, and January of 2014 in the amounts of 6%, 8%, 6%, and 2.0% respectively. The Commission-adopted budget and forecast has future overall rate increases of 2.0% for the foreseeable future. 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 its power requirements over BPA's nonpreference customers consistent with the provisions of Section 5.b.1 of the Northwest Regional Power Act. In 2013, 2012, and 2011 the District purchased 1%, 1%, and 32%, 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,

## **PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON**

### **MANAGEMENT'S DISCUSSION AND ANALYSIS DECEMBER 31, 2013 AND 2012**

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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.

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 May of 2019. 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 completed the long-term turbine upgrade project at Wanapum Dam. In October of 2013, the tenth and final turbine and fourth generator were commissioned and began generating power. In February of 2012, the eighth turbine and second generator were completed. In December of 2012, the ninth turbine and third generator were completed. In April of 2011, the seventh turbine and the first generator were completed. As of December 31, 2013, the cost of the remaining Wanapum generators to be replaced is estimated at \$90.8 million.

In an effort to increase net revenue stability by improving the predictability of wholesale revenues, the District entered into two contracts to sell a portion of the Electric System's share from the Priest Rapids Project (PRP) to Iberdrola Renewables, Inc. and Shell Energy North America. The \$104.4 million Iberdrola contract for 12% of PRP output was effective December 1, 2011, and terminates November 30, 2014. The \$102.4 million Shell contract for 10% of PRP output was effective July 1, 2013, and terminates June 30, 2016. These contracts are paid in 36 equal monthly installments over the life of the agreement. The District regularly monitors its exposure with Iberdrola and Shell 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 was completed on schedule and entered service early in 2014 at a cost of approximately \$38.6 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.

## **PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON**

### **MANAGEMENT'S DISCUSSION AND ANALYSIS DECEMBER 31, 2013 AND 2012**

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Wanapum consists of a dam and hydroelectric generating station having a nameplate rating of 1,111,400 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.

During the year ended December 31, 2013, the Priest Rapids Project provided 8,945,411 megawatt hours ("MWh") of electric energy at an average cost of \$16.31 per MWh. During the year ended December 31, 2012, the Priest Rapids Project provided 8,747,538 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.

While operating costs have remained generally consistent, the change in average costs per MWh at the Priest Rapids Project from 2011 to 2013 was driven primarily by runoff water available for generation. Runoff was 103%, 120%, and 126% of average for 2013, 2012, and 2011, respectively. The timing of the runoff and spill requirements factor into the water available for generation from year to year.

As described in Note 12, damage to the Wanapum Dam was discovered in February 2014. While this condition, and the related corrective actions undertaken by the District, are disclosed in that footnote as a subsequent event, such circumstances had no impact on the District's financial position or results of operations for the periods covered in these financial statements.

# PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

## MANAGEMENT'S DISCUSSION AND ANALYSIS DECEMBER 31, 2013 AND 2012

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### CONDENSED COMPARATIVE FINANCIAL INFORMATION (AMOUNTS IN THOUSANDS)

<b>Statements of Net Position</b>	<b>2013</b>	<b>2012 *</b>	<b>2011 *</b>
<b>Assets</b>			
Current	\$ 266,417	\$ 228,113	\$ 220,464
Net utility plant	1,689,361	1,515,539	1,408,063
Noncurrent	<u>238,845</u>	<u>299,213</u>	<u>343,607</u>
Total assets	\$ 2,194,623	\$ 2,042,865	\$ 1,972,134
Deferred outflows of resources	<u>7,334</u>	<u>7,753</u>	<u>5,780</u>
Total assets and deferred outflows of resources	<u>\$ 2,201,957</u>	<u>\$ 2,050,618</u>	<u>\$ 1,977,914</u>
<b>Liabilities</b>			
Current	\$ 150,413	\$ 142,025	\$ 128,352
Noncurrent	<u>1,201,579</u>	<u>1,125,344</u>	<u>1,119,615</u>
Total liabilities	<u>1,351,992</u>	<u>1,267,369</u>	<u>1,247,967</u>
<b>Net position</b>			
Invested in capital assets, net of related debt	530,428	522,650	522,206
Restricted	107,456	95,051	74,869
Unrestricted	<u>212,081</u>	<u>165,548</u>	<u>132,872</u>
Total net position	<u>849,965</u>	<u>783,249</u>	<u>729,947</u>
Total liabilities and net position	<u>\$ 2,201,957</u>	<u>\$ 2,050,618</u>	<u>\$ 1,977,914</u>
<b>Revenues and Expenses and Changes in Net Position</b>			
Operating revenues	\$ 290,427	\$ 263,252	\$ 293,065
Operating expenses	<u>201,509</u>	<u>176,267</u>	<u>204,608</u>
Net operating income	<u>88,918</u>	<u>86,985</u>	<u>88,457</u>
Other revenues (expenses)	(34,168)	(37,531)	(39,350)
Contributions in aid of construction	<u>11,966</u>	<u>3,848</u>	<u>8,660</u>
Change in net position	<u>\$ 66,716</u>	<u>\$ 53,302</u>	<u>\$ 57,767</u>

\* The District's 2012 and 2011 Statements of Net Position and Statements of Revenues and Expenses and Changes in Net Position were updated for the impacts of the required retroactive implementation of GASB Statement No. 65, "Items Previously Reported as Assets and Liabilities," which became effective for the District in 2013. See Note 1 for a summary of this change in accounting principle.

# **PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON**

## **MANAGEMENT'S DISCUSSION AND ANALYSIS DECEMBER 31, 2013 AND 2012**

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### **FINANCIAL ANALYSIS**

The following discussion provides comparative financial information for the years ended December 31, 2013, 2012, and 2011. The years 2012 and 2011 have been restated to reflect changes in accounting principles per GASB 65.

#### **ASSETS**

Current assets from 2011 to 2013 have fluctuated 21%. Materials, supplies and receivables have remained consistent. The majority of the increase is due to increases in cash and investments reflective of favorable operating results.

Net plant increased 8% from 2011 to 2012 and 11% from 2012 to 2013. 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.

Noncurrent assets have decreased 30% between 2011 and 2013. The ebbs and flows of the non-current assets balance are 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.

Deferred outflows represent the unamortized loss on refunding of debt. These balances have increased from 2011 to 2013 by 27% as a result of several refunding of debt transactions executed during this period.

#### **LIABILITIES**

The District had approximately \$1.15 billion in bonded debt as of year ended December 31, 2013, and \$1.1 billion for years ended December 31, 2012, and 2011, all of which is at fixed rates. In August of 2013, the District issued bonds to finance capital improvements for the Priest Rapids Project. The total par value of the bond offering was \$100.1 million. The bonds were issued at fixed interest rates at an initial offering premium of \$1.2 million. In September of 2013, the District issued \$67.6 million in Electric System revenue refunding bonds to retire \$56.8 million of 2011-I revenue and refunding bonds. The 2013 Electric System bonds were issued at fixed interest rates at a net original issue premium of \$815 thousand. This refunding allowed the District to restructure debt service to moderate retail electric rate increases in the foreseeable future. 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



# **PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON**

## **MANAGEMENT'S DISCUSSION AND ANALYSIS DECEMBER 31, 2013 AND 2012**

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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.

In August of 2013, Standard and Poor's raised its long-term rating and underlying rating to AA/stable from AA-/stable for the Electric System, Priest Rapids, Wanapum and the Priest Rapids Project System's bonds. The previous rating had been in effect since March of 2010. The rationale for the raise included very strong operations, strong availability, extremely low production costs, and improved liquidity for the Priest Rapids Project and the Electric System's benefit from increasing industrial loads, willingness to increase rates, an extremely low-cost power supply, lack of additional debt needs, and strong financial and risk management practices. In August of 2013, Fitch Ratings reaffirmed their AA/stable rating which has been in effect since 2005 on all District bonds based on low-cost power, ample generation capacity, and favorable risk-management practices and cash reserves to manage volatility. In the same month, Moody's reaffirmed their Aa3/stable rating which has been in effect since 2010 on all District bonds citing competitive hydro generation, low retail rates, strong liquidity, and forecasted financial performance.

### **NET POSITION**

Net position increased by \$66.7 million, \$53.3 million and \$57.7 million in 2013, 2012, and 2011 respectively. This is reflective of ample generation and surplus power sales due largely to above average river flows of 103% of average for 2013, 120% for 2012, and 126% for 2011.

### **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. 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 increase in operating revenues from 2012 to 2013 is primarily due to the retail rate increase and the \$20 million increase in Sales to other utilities, much of which is attributed to the slice sale to Shell Energy which was in place for the last six months of 2013. The expiration of the BPA block contract as of September 30, 2011, resulted in a decrease of Purchased power expense of \$29.5 million from 2011 to 2012. Operating expenses increased from 2012 to 2013 by \$25 million. \$12 million of this increase is related to Purchased Power. This increase was expected and generally relates to covering the slice sales related to Shell Energy and Iberdrola which help to reduce water risk and price exposure for the District. Other operating expense increases included distribution, administrative and general, license compliance, depreciation and amortization, and taxes ranging from 5% to 15% increase from 2012.

Other revenues (expenses) remained flat from 2011 to 2013.

## **PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON**

### **MANAGEMENT'S DISCUSSION AND ANALYSIS DECEMBER 31, 2013 AND 2012**

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Contributions in aid of construction ("CIAC's") for 2011 and 2013 were \$8.7 million and \$12.0 million, respectively, with SGL Automotive and Microsoft making up the majority of the contributions. CIAC's of \$3.8 million for 2012 are more reflective of normal expansion of the Electric System.

#### **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, 2013 AND 2012 (AMOUNTS IN THOUSANDS)

ASSETS	2013	2012 (Restated)
<b>CURRENT ASSETS</b>		
Cash	\$ 15,227	\$ 5,524
Investments	146,766	101,724
Restricted funds		
Cash	8,450	9,014
Investments	56,941	69,494
Customer accounts receivable, net of allowance for uncollectible accounts	18,431	21,144
Materials and supplies	18,880	19,216
Other current assets	1,722	1,997
Total current assets	266,417	228,113
<b>NONCURRENT ASSETS</b>		
Investments	56,228	35,885
Restricted funds		
Cash	9,353	10,645
Investments	168,627	246,785
Conservation loans	722	791
Demand-side management	2,563	3,604
Preliminary expenses	1,352	1,503
Total other noncurrent assets	238,845	299,213
Utility plant, net of accumulated depreciation and amortization	1,689,361	1,515,539
Total noncurrent assets	1,928,206	1,814,752
<b>TOTAL ASSETS</b>	2,194,623	2,042,865
<b>DEFERRED OUTFLOWS OF RESOURCES</b>	7,334	7,753
<b>TOTAL ASSETS AND DEFERRED OUTFLOWS OF RESOURCES</b>	\$ 2,201,957	\$ 2,050,618

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, 2013 AND 2012  
(AMOUNTS IN THOUSANDS)**

<b>LIABILITIES AND NET POSITION</b>	<b>2013</b>	<b>2012 (Restated)</b>
<b>CURRENT LIABILITIES</b>		
Accounts payable		
Trade	\$ 30,654	\$ 35,881
Wages payable	12,509	12,077
Power purchasers	845	3,377
Accrued taxes	5,627	5,351
Customer deposits	11,521	3,794
Accrued bond interest	27,770	27,457
Unearned revenue	11	107
Habitat liability	12,417	11,430
Other current liabilities	10,324	40
Current portion of licensing obligations	3,445	3,646
Current portion of long-term debt	35,290	38,865
	<u>150,413</u>	<u>142,025</u>
Total current liabilities		
	<u>150,413</u>	<u>142,025</u>
<b>NONCURRENT LIABILITIES</b>		
Accrued other postemployment benefits	1,472	1,240
Long-term unearned revenue	1,286	1,393
Licensing obligations, less current portion	54,350	46,550
Revenue bonds, less current portion	1,117,450	1,041,810
Unamortized (discount) premium, net	27,021	34,351
	<u>1,201,579</u>	<u>1,125,344</u>
Total noncurrent liabilities		
	<u>1,201,579</u>	<u>1,125,344</u>
Total liabilities	<u>1,351,992</u>	<u>1,267,369</u>
	<u>1,351,992</u>	<u>1,267,369</u>
<b>NET POSITION</b>		
Invested in capital assets, net of related debt	530,428	522,650
Restricted	107,456	95,051
Unrestricted	212,081	165,548
	<u>849,965</u>	<u>783,249</u>
Total net position		
	<u>849,965</u>	<u>783,249</u>
<b>TOTAL LIABILITIES AND NET POSITION</b>	<u>\$ 2,201,957</u>	<u>\$ 2,050,618</u>

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, 2013 AND 2012 (AMOUNTS IN THOUSANDS)

	2013	2012 (Restated)
<b>OPERATING REVENUES</b>		
Sales to power purchasers at cost	\$ 55,641	\$ 52,353
Retail energy sales		
Residential	39,491	35,898
Irrigation	20,873	19,501
Commercial and industrial	88,107	87,492
Governmental and others	1,033	1,019
Sales to other utilities	79,363	61,782
Wholesale fiber optic network sales	4,404	3,833
Other	1,515	1,374
	290,427	263,252
<b>OPERATING EXPENSES</b>		
Purchased power	30,634	17,395
Generation	23,384	23,923
Transmission	7,924	8,449
Distribution	15,272	13,420
Customer and information services	7,318	6,804
Wholesale fiber optic network operations	1,470	1,290
Administrative and general	30,591	26,584
License compliance and related agreements	20,711	18,276
Depreciation and amortization	50,474	47,857
Taxes	13,731	12,269
	201,509	176,267
<b>NET OPERATING INCOME</b>	88,918	86,985
<b>OTHER REVENUES (EXPENSES)</b>		
Interest and other income	(236)	3,477
Interest on revenue bonds and other, net of capitalized interest	(43,796)	(51,364)
Federal rebates on revenue bonds	7,712	7,809
Amortization of debt discount/premium and cost of debt issuance	2,152	2,547
	(34,168)	(37,531)
<b>CONTRIBUTIONS IN AID OF CONSTRUCTION</b>	11,966	3,848
<b>CHANGE IN NET POSITION</b>	\$ 66,716	\$ 53,302
<b>NET POSITION</b>		
Beginning of year	783,249	729,947 <sup>1</sup>
End of year	\$ 849,965	\$ 783,249

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, 2013 AND 2012 (AMOUNTS IN THOUSANDS)

	2013	2012
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Cash received from retail energy sales	\$ 148,135	\$ 141,818
Cash received from sales to power purchasers at cost	51,091	52,360
Cash received from sales to other utilities	83,471	62,204
Other cash receipts	5,605	5,190
Cash paid for customer deposits	7,654	844
Cash paid for purchase of power	(24,725)	(20,225)
Cash paid to contractors, suppliers, and employees	(97,911)	(96,897)
Taxes paid	(13,457)	(11,848)
	159,863	133,446
<b>CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES</b>		
Principal paid on revenue bonds	(38,855)	(31,520)
Interest paid on revenue bonds	(43,482)	(49,251)
Federal interest rebates	7,712	7,809
Bond proceeds	169,685	139,361
Payment on refunded debt	(62,107)	(92,448)
Bond issuance cost	(1,417)	(976)
Cash received from contributions in aid of construction	22,344	2,548
Licensing obligation payments	(3,564)	(3,407)
Acquisition and construction of plant assets	(228,067)	(146,327)
Proceeds on sale of plant assets	579	249
Miscellaneous nonoperating income	466	847
	(176,706)	(173,115)
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Purchase of investment securities	(471,871)	(453,286)
Sale proceeds of investment securities	448,593	498,067
Investment income proceeds	1,900	2,525
Net repurchase agreement	45,999	-
Cash paid for conservation loans	69	(78)
	24,690	47,228
<b>NET INCREASE IN CASH</b>	<b>\$ 7,847</b>	<b>\$ 7,559</b>

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, 2013 AND 2012 (AMOUNTS IN THOUSANDS)

	<b>2013</b>	<b>2012</b>
CASH AT END OF YEAR	\$ 33,030	\$ 25,183
CASH AT BEGINNING OF YEAR	25,183	17,624
NET INCREASE IN CASH	\$ 7,847	\$ 7,559
<b>OPERATING ACTIVITIES</b>		
Net operating income	\$ 88,918	\$ 86,985
Adjustments to reconcile net operating income to net cash provided by (used in) operating activities:		
Depreciation and amortization	50,474	47,857
Accretion expense	2,475	2,544
Earned revenue from deposits	(107)	(107)
Provision for uncollectible accounts	(79)	(4)
Cash provided by (used in) changes in operating assets and liabilities:		
Change in Habitat funds held in trust	800	1,458
Customer accounts receivable	2,601	(1,803)
Materials and supplies	336	603
Other current assets	275	(398)
Trade and wages payables	5,620	(5,117)
Payable to power purchasers, net	356	7
Accrued taxes	275	432
Customer deposits	7,687	816
Accrued other postemployment benefits	232	173
NET CASH PROVIDED BY OPERATING ACTIVITIES	\$ 159,863	\$ 133,446

<b>Supplemental Disclosure (Amounts In Thousands)</b>	<b>2013</b>	<b>2012</b>
Change in construction costs included in accounts payable	\$ 6,457	\$ (6,257)

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, 2013 AND 2012**

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### **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 13. 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, 2013 and 2012, respectively.

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



# PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

## NOTES TO THE FINANCIAL STATEMENTS DECEMBER 31, 2013 AND 2012

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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.

***Change in Accounting Principle*** – 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. GASB Statement No. 65 no longer allows debt issuance costs to be classified as an asset and requires that they be expensed in the year incurred. Losses on refunding debt have been reclassified as deferred outflows of resources and restated to reflect the exclusion of bond issuance costs that are now expensed in the period incurred. The requirements of Statement No. 65 are effective for the District for the year ending December 31, 2013. The implementation of GASB 65 resulted in a reduction to previously reported Net Position of approximately \$9.3 million as of January 1, 2012 and to the following balances as of December 31, 2012 and for the year then ended:

	December 31,	
	2012 (Restated)	2012 (Previous)
	(thousands of dollars)	
<b>STATEMENTS OF NET POSITION</b>		
NONCURRENT ASSETS		
Total other noncurrent assets	\$ 299,213	\$ 306,926
DEFERRED OUTFLOWS		
Unamortized refunding loss	7,753	-
NONCURRENT LIABILITIES		
Total noncurrent liabilities	1,125,344	1,116,159
NET POSITION		
Invested in capital assets, net of related debt	522,650	531,794
<b>STATEMENTS OF REVENUES AND EXPENSES AND CHANGE IN NET POSITION</b>		
OTHER REVENUES (EXPENSES)		
Total other revenues (expenses)	(37,531)	(37,677)

## PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

### NOTES TO THE FINANCIAL STATEMENTS DECEMBER 31, 2013 AND 2012

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**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 2013 and 2012, the allowance for uncollectible accounts was \$245,000 and \$324,000, 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 \$12.0 million and \$3.8 million of contributions in aid of construction for the years ended December 31, 2013 and 2012, 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 4.23% and 3.32% for 2013 and 2012, respectively. Interest capitalized during 2013 and 2012 was \$10.4 million and \$2.2 million, respectively.

**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 2.31% and 2.33% for 2013 and 2012, 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.

## PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

### NOTES TO THE FINANCIAL STATEMENTS DECEMBER 31, 2013 AND 2012

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***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.

***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 recognized in the period incurred.

***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

## PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

### NOTES TO THE FINANCIAL STATEMENTS DECEMBER 31, 2013 AND 2012

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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.
- *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, 2013. The District is involved in litigation with results that are uncertain but the risk to the District at this time is considered immaterial.

**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

# **PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON**

## **NOTES TO THE FINANCIAL STATEMENTS DECEMBER 31, 2013 AND 2012**

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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 unbilled revenue, Licensing obligations, allowance for uncollectible accounts, Accrued other postemployment benefits, and 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 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, 2013 and 2012, 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, 2013 AND 2012

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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)	2013	2012
Unrestricted assets:		
Unrestricted funds:		
Revenue and Service System funds	<u>\$ 97,009</u>	<u>\$ 69,953</u>
Board designated funds:		
Electric System Reserve and Contingency fund	120,111	72,070
Self-Insurance Reserve fund	<u>1,101</u>	<u>1,110</u>
Total board designated funds	<u>121,212</u>	<u>73,180</u>
Total unrestricted funds	<u>218,221</u>	<u>143,133</u>
Restricted:		
Construction funds	70,822	176,966
Bond Sinking funds	58,028	55,675
Debt Service Reserve funds	47,897	37,649
Bond Interest funds	27,791	27,479
Renewal, Replacement and Contingency fund	24,626	24,317
Habitat funds	12,496	12,138
Quincy Chute Renewal and Replacement fund	<u>1,711</u>	<u>1,714</u>
Total restricted funds	<u>243,371</u>	<u>335,938</u>
Total	<u>\$ 461,592</u>	<u>\$ 479,071</u>

**Interest Rate Risk** – The District has adopted a formal investment policy and an investment oversight committee which monitors its investment position limitations as a means of managing its exposure to fair value losses arising from increasing interest rates.

**Credit Risk** – The District has adopted a formal investment policy that specifies minimal credit rating acceptability criteria of potential investment issuers as well as both a wholesale and retail electric power customer credit risk management program as a means of managing the District's exposure to credit risk.

**Concentration of Credit Risk** – The District's adopted investment policy states that no more than thirty percent (30%) of the total portfolio par value will be invested in a single security

## PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

### NOTES TO THE FINANCIAL STATEMENTS DECEMBER 31, 2013 AND 2012

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type, with the exception of direct US Government obligations, repurchase agreements collateralized by the same, and the state investment pool. Credit concentration of the District's investment portfolio is actively monitored by the investment oversight committee as required by the District's adopted investment policy.

The District's investments at December 31, 2013 and 2012, 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 for 2013 and 2012.

During 2013 and 2012, the District realized \$2.0 million and \$1.8 million of interest earnings and realized gains from investments, respectively. The unrealized gain on investments held at December 31, 2013 and 2012, was \$2.8 million and \$341 thousand, 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 were as follows:

(amounts in thousands)	2013	2012
U.S. agencies	\$ 162,470	\$ 165,854
U.S. treasuries	175,447	164,871
Money market funds	55,467	56,008
Repurchase agreements	6,000	52,000
Municipal bonds	27,815	13,752
Total investments	<u>427,199</u>	<u>452,485</u>
Cash	<u>33,030</u>	<u>25,183</u>
Total cash and investments	<u>\$ 460,229</u>	<u>\$ 477,668</u>

# PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

## NOTES TO THE FINANCIAL STATEMENTS DECEMBER 31, 2013 AND 2012

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The District places a limit of no more than thirty percent (30%) on the amounts invested in any one issuer for federal agency securities. The investment oversight committee actively monitors portfolio composition and seeks to ensure prudent diversification is maintained. The following are the concentrations of risk greater than 5%, in either year. The credit ratings listed are from Standard and Poor's as of December 31, 2013. TSY refers to U.S. Treasury securities and N/R means not rated.

	<b>Credit Rating</b>	<b>2013</b>	<b>2012</b>
U.S. treasuries	TSY	38%	37%
FNMA Discount Notes	AA+	8%	15%
Federal Home Loan Mortgage Corp.	n/a	7%	less than 5%
Money market funds	N/R	13%	12%
Repurchase agreements	N/R	less than 5%	12%
Federal Home Loan Bank	AA+	13%	13%
Federal Farm Credit	AA+	11%	6%



## PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

### NOTES TO THE FINANCIAL STATEMENTS DECEMBER 31, 2013 AND 2012

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#### 3. UTILITY PLANT

Utility plant of the District as of December 31, 2013, is summarized as follows:

(amounts in thousands)	Balance 2012	Additions	Retirements/ Transfers	Balance 2013
Distribution facilities	\$ 441,068	\$ 21,258	\$ (281)	\$ 462,045
Transmission facilities	162,114	8,101	-	170,215
Hydro facilities				
Power plant structures	57,208	3,932	-	61,140
Reservoirs, dams, waterways	411,469	527	(1,744)	410,252
Power plant equipment	464,031	47,257	(2,509)	508,779
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	297,766	10,430	-	308,196
FERC License	110,646	8,689	-	119,335
Other intangible assets	5,667	13,841	-	19,508
Total	1,984,220	114,035	(4,534)	2,093,721
Accumulated depreciation and amortization	(715,183)	(50,537)	2,056	(763,664)
Subtotal	1,269,037	63,498	(2,478)	1,330,057
Land and land rights	24,577	-	41	24,618
Construction in progress	221,925	214,177	(101,416)	334,686
Total net utility plant	\$ 1,515,539	\$ 277,675	\$ (103,853)	\$ 1,689,361

## PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

### NOTES TO THE FINANCIAL STATEMENTS DECEMBER 31, 2013 AND 2012

(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
	<u>1,831,057</u>	<u>157,357</u>	<u>(4,194)</u>	<u>1,984,220</u>
Total	1,831,057	157,357	(4,194)	1,984,220
Accumulated depreciation and amortization	(670,942)	(48,435)	4,194	(715,183)
	<u>1,160,115</u>	<u>108,922</u>	<u>-</u>	<u>1,269,037</u>
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
	<u>\$ 1,408,063</u>	<u>\$ 260,917</u>	<u>\$ (153,441)</u>	<u>\$ 1,515,539</u>
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, 2013 AND 2012**

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### **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 \$57.8 million as of December 31, 2013, of which approximately \$3.4 million is expected to be paid within one year. The present value of the obligations was \$50.2 million as of December 31, 2012. 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.

### **5. REVENUE BONDS**

In August of 2013, the District issued \$100.1 million of revenue bonds associated with the Priest Rapids Project. The bonds were issued at fixed interest rates at an initial offering premium of \$1.2 million. The bonds were issued to finance improvements at the Priest Rapids Project, to pay issuance costs, and to fund a debt service reserve.

In September of 2013, the District issued \$67.6 million in Electric System revenue refunding bonds to retire \$56.8 million of 2011-I revenue and refunding bonds. The 2013 Electric System bonds were issued at fixed interest rates at a net original issue premium of \$815 thousand. The District realized a \$1.3 million refunding loss associated with unamortized discounts/premiums. 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 realized a \$5.4 million refunding loss associated with unamortized discounts/premiums, and bond issuance costs on this transaction.

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 13.

# PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

## NOTES TO THE FINANCIAL STATEMENTS DECEMBER 31, 2013 AND 2012

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

(amounts in thousands)	2013	2012
Electric System, interest rates of 3.0% to 5.0%, maturing through 2023	\$ 151,340	\$ 151,735
Priest Rapids Project, interest rates of .55% to 5.83%, maturing through 2043	<u>1,001,400</u>	<u>928,940</u>
 Total revenue bonds outstanding	 <u>\$ 1,152,740</u>	 <u>\$ 1,080,675</u>

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

(amounts in thousands)	Principal	Interest	Total
2014	\$ 35,290	\$ 56,288	\$ 91,578
2015	29,000	56,401	85,401
2016	29,330	55,091	84,421
2017	30,650	53,701	84,351
2018	30,275	52,245	82,520
2019 - 2023	217,630	230,671	448,301
2024 - 2028	229,600	179,789	409,389
2029 - 2033	228,785	116,172	344,957
2034 - 2038	188,700	60,794	249,494
2039 - 2043	<u>133,480</u>	<u>14,690</u>	<u>148,170</u>
 Total	 <u>\$ 1,152,740</u>	 <u>\$ 875,842</u>	 <u>\$ 2,028,582</u>

For the years ending December 31, 2013 and 2012, 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, 2013 AND 2012

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

(amounts in thousands)	Balance 2012	Additions	Reductions	Balance 2013	Due Within One Year
Revenue bonds payable	\$ 1,080,675	\$ 167,695	\$ (95,630)	\$ 1,152,740	\$ 35,290
Unamortized premiums and discounts, net	<u>34,351</u>	<u>1,990</u>	<u>(9,320)</u>	<u>27,021</u>	<u>-</u>
Total	<u>\$ 1,115,026</u>	<u>\$ 169,685</u>	<u>\$ (104,950)</u>	<u>\$ 1,179,761</u>	<u>\$ 35,290</u>

(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	<u>28,053</u>	<u>11,741</u>	<u>(5,443)</u>	<u>34,351</u>	<u>-</u>
Total	<u>\$ 1,101,183</u>	<u>\$ 139,361</u>	<u>\$ (125,518)</u>	<u>\$ 1,115,026</u>	<u>\$ 38,865</u>

## 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 2013 and 2012, the District incurred 61% of Priest Rapids Project power costs with power purchasers funding 39%. 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 signed a BPA preference contract during 2008 to serve its Grand Coulee load of approximately 5 aMW that expires September 30, 2028. The District has purchased, from BPA, the transmission required 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

# PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

## NOTES TO THE FINANCIAL STATEMENTS DECEMBER 31, 2013 AND 2012

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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 expired 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 was completed in early 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)

2014	\$	2,844
2015		2,918
2016		2,346
2017		2,605
2018		2,745

### **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.

# **PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON**

## **NOTES TO THE FINANCIAL STATEMENTS DECEMBER 31, 2013 AND 2012**

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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 \$2,266,513 and \$422,898 during 2013 and 2012, respectively. The estimated cost for this agreement is approximately \$2.0 million for 2014. The projected average annual cost for this agreement from 2014 to 2019 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.

## **7. NONPOWER COMMITMENTS**

### **Capital Projects**

The District has contractual commitments relating to several Electric System capital improvement projects including fiber design/build, mobile radio replacement electrical system upgrades, multiple transformer purchases, power cable purchases, and substation and distribution line construction projects over the next few years totaling approximately \$34.8 million as of December 31, 2013.

The District's improvement programs for the Priest Rapids Project include restoration or replacement of generators, turbine model testing, construction and upgrades to project support buildings, construction of a fish bypass project, construction and renovation of hatcheries, construction of recreation facilities, supplying GSU transformers and supplying trunnion cylindrical bearings for spillway gates. 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 \$95.4 million as of December 31, 2013.

## **PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON**

### **NOTES TO THE FINANCIAL STATEMENTS DECEMBER 31, 2013 AND 2012**

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#### **Other Commitments**

In 2006, the District entered into a Salmon and Steelhead Settlement Agreement with the United States Department of Interior, the 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).

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



## **PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON**

### **NOTES TO THE FINANCIAL STATEMENTS DECEMBER 31, 2013 AND 2012**

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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.

The District’s total contributions to these Habitat funds for the years ended December 31, 2013, and December 31, 2012, equaled \$3.4 million and \$3.3 million, respectively. These contributions reduced the Licensing obligations, as discussed in Note 4.

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The following table shows the District's estimate of the remaining fixed contributions to the Habitat funds as of December 31, 2013, representing required contributions through the New License term.

### Estimated Fixed Habitat Funding Commitments

(amounts in thousands)

2014	\$	3,445
2015		3,620
2016		3,697
2017		2,479
2018		2,530
2019 and thereafter		123,289
Total	\$	<u>139,060</u>

**Participation In Northwest Open Access Network, Inc. D.B.A. NoaNet** - The District, along with 9 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, 2013, was \$8.2 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 17.57% of the bonds.

The management of NoaNet anticipates meeting its cost of operations through revenues, thus no annual assessment for 2013 was needed.

For the NoaNet final 2013 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.

## 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

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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](http://www.drs.wa.gov). The following disclosures are made pursuant to GASB Statements 27, Accounting for Pensions by State and Local Government Employers and 50, Pension Disclosures, an Amendment of GASB Statements 25 and 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; employees of legislative committees; employees of district and municipal courts; and employees of local governments. Membership also includes higher education employees not participating in higher education retirement programs. Approximately 49 percent of PERS salaries are accounted for by state employment. 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 Plan 3. The option must be exercised within 90 days of employment. Employees who fail to choose within 90 days default to Plan 3.

PERS is comprised of and reported as three separate plans for accounting purposes: Plan 1, Plan 2/3, and Plan 3. Plan 1 accounts for the defined benefits of Plan 1 members. Plan 2/3 accounts for the defined benefits of Plan 2 members, and the defined benefit portion of benefits for Plan 3 members. Plan 3 accounts for the defined contribution portion of benefits for Plan 3 members. Although members can only be a member of either Plan 2 or Plan 3, the defined benefit portions of Plan 2 and Plan 3 are accounted for in the same pension trust fund. All assets of this Plan 2/3 may legally be used to pay the defined benefits of any of the Plan 2 or Plan 3 members or beneficiaries, as defined by the terms of the plan. Therefore, Plan 2/3 is considered to be a single plan for accounting purposes.

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PERS Plan 1 and Plan 2 retirement benefits are financed from a combination of investment earnings and employer and employee contributions. Employee contributions to the PERS Plan 1 and Plan 2 defined benefit plans accrue interest at a rate specified by the Director of DRS. During DRS' Fiscal Year 2013, the rate was five and one-half percent compounded quarterly. Members in PERS Plan 1 and Plan 2 can elect to withdraw total employee contributions and interest thereon, in lieu of any retirement benefit, upon separation from PERS-covered employment.

PERS Plan 1 members are vested after the completion of five years of eligible service.

PERS Plan 1 members are eligible for retirement from active status at any age with at least 30 years of service, at age 55 with 25 years of service, or at age 60 with at least 5 years of service. Plan 1 members retiring from inactive status prior to the age of 65 may receive actuarially reduced benefits.

The monthly benefit is 2 percent of the average final compensation (AFC) per year of service, but the benefit may not exceed 60 percent of the AFC. The AFC is the monthly average of the 24 consecutive highest-paid service credit months.

PERS Plan 1 retirement benefits are actuarially reduced to reflect the choice, if made, of a survivor option.

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. The benefit 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, at which time the benefit is converted to the member's service retirement amount.

A member with five years of covered employment is eligible for non-duty disability retirement. Prior to the age of 55, the benefit 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. Plan 1 members may elect to receive an optional COLA amount (based on the Consumer Price Index), capped at 3 percent annually. To offset the cost of this annual adjustment, the benefit is reduced.

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. The AFC is the monthly average

## **PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON**

### **NOTES TO THE FINANCIAL STATEMENTS DECEMBER 31, 2013 AND 2012**

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of the 60 consecutive highest-paid service months. 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 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.

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, if hired prior to May 1, 2013:

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

PERS Plan 2 members hired on or after May 1, 2013 have the option to retire early by accepting a reduction of 5 percent for each year of retirement before age 65. This option is available only to those who are age 55 or older and have at least 30 years of service.

PERS Plan 2 retirement benefits are actuarially reduced to reflect the choice, if made, of a survivor option.

PERS Plan 3 has a dual benefit structure. Employer contributions finance a defined benefit component and member contributions finance a defined contribution component. As established by Chapter 41.34 RCW, employee contribution rates to the defined contribution component range from 5 percent to 15 percent of salaries, based on member choice. Members who do not choose a contribution rate default to a 5 percent rate. There are currently no requirements for employer contributions to the defined contribution component of PERS Plan 3.

PERS Plan 3 defined contribution retirement benefits are dependent upon the results of investment activities. Members may elect to self-direct the investment of their contributions. Any expenses incurred in conjunction with self-directed investments are paid by members. Absent a member's self-direction, PERS Plan 3 contributions are invested in the Retirement Strategy Fund that assumes the member will retire at age 65.

For DRS' Fiscal Year 2013, PERS Plan 3 employee contributions were \$99.0 million, and plan refunds paid out were \$69.4 million.

The defined benefit portion of PERS Plan 3 provides members a monthly benefit that is 1 percent of the AFC per year of service. The AFC is the monthly average of the 60 consecutive highest-paid service months. There is no cap on years of service credit, and Plan 3 provides the same cost-of-living allowance as Plan 2.

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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 by 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, and were hired before May 1, 2013, 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.
- If they have 30 service credit years, are at least 55 years old, and were hired after May 1, 2013, they have the option to retire early by accepting a reduction of 5 percent for each year before age 65.

PERS Plan 3 benefits are actuarially reduced to reflect the choice, if made, of a survivor option.

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 members meeting specific eligibility requirements have options available to enhance their retirement benefits. Some of these options are available to their survivors.

A one-time duty-related death benefit is provided to the beneficiary or the estate of a PERS member who dies 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 the member's covered employment, if found eligible by the Department of Labor and Industries.

From January 1, 2007 through December 31, 2007, judicial members of PERS were given the choice to elect participation in the Judicial Benefit Multiplier (JBM) Program enacted in 2006. Justices and judges in PERS Plan 1 and Plan 2 were able to make an irrevocable

# PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

## NOTES TO THE FINANCIAL STATEMENTS DECEMBER 31, 2013 AND 2012

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election to pay increased contributions that would fund a retirement benefit with a 3.5 percent multiplier. The benefit would be capped at 75 percent of AFC. Judges in PERS Plan 3 could elect a 1.6 percent of pay per year of service benefit, capped at 37.5 percent of AFC.

Newly elected or appointed justices and judges who chose to become PERS members on or after January 1, 2007, or who had not previously opted into PERS membership, were required to participate in the JBM Program.

There are 1,176 participating employers in PERS. Membership in PERS consisted of the following as of the latest actuarial valuation date for the plans of June 30, 2012 :

Retirees and Beneficiaries Receiving Benefits	82,242
Terminated Plan Members Entitled to But Not Yet Receiving Benefits	30,515
Active Plan Members Vested	106,317
Active Plan Members Nonvested	44,273
	<hr/>
Total	263,347

### 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. 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.

As a result of the implementation of the Judicial Benefit Multiplier Program in January 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 that 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.

The required contribution rates expressed as a percentage of current-year covered payroll, as of December 31, 2013, are as follows:

# PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

## NOTES TO THE FINANCIAL STATEMENTS DECEMBER 31, 2013 AND 2012

	PERS Plan 1	PERS Plan 2	PERS Plan 3
Employer*	9.21%**	9.21%**	9.21%***
Employee	6.00%****	4.92%****	*****

- \* The employer rates include the employer administrative expense fee currently set at 0.18%.
- \*\* The employer rate for state elected officials is 13.73% for Plan 1 and 9.21% 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 4.92% 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
2013	\$ 246	\$ 3,843	\$ 1,018
2012	356	3,269	854
2011	211	2,747	727

**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 \$898,327 and \$842,426 in 2013 and 2012, respectively.

### 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



# PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

## NOTES TO THE FINANCIAL STATEMENTS DECEMBER 31, 2013 AND 2012

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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 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, 2013 and 2012, the District paid approximately \$234,000 and \$286,000 in retiree subsidies, respectively.

### 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, 2013 and 2012:

(amounts in thousands)	2013	2012
Normal cost with interest	\$ 198	\$ 187
Amortization amount with interest	268	271
	<u>          </u>	<u>          </u>
Annual required contribution	\$ 466	\$ 458
	<u>          </u>	<u>          </u>
Annual OPEB cost	\$ 466	\$ 458
Less: benefit payments	(234)	(286)
	<u>          </u>	<u>          </u>
Increase in net OPEB obligation	232	172
Net OPEB obligation at beginning of year	1,240	1,068
	<u>          </u>	<u>          </u>
Net OPEB obligation at end of year	\$ 1,472	\$ 1,240
	<u>          </u>	<u>          </u>

# PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

## NOTES TO THE FINANCIAL STATEMENTS DECEMBER 31, 2013 AND 2012

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### **Funded Status and Funding Progress**

As of December 31, 2013 and 2012, the District's Actuarial Accrued Liability ("AAL") was \$4.1 million and \$4.2 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 2013 and 2012, the covered payroll (annual payroll of active employees covered by the plan) was \$54.4 million and \$52.5 million, respectively, and the ratio of the unfunded obligation to the covered payroll was 7.6% and 8.0%, 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 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, 2013. The Entry Age Normal method is used to develop an Annual Required Contribution and an Actuarial Accrued Liability. Use of the EAN Level Percent of Pay method for the OPEB Plan is a change from the prior year valuation, which used the Projected Unit Cost method to value OPEB benefits. This change in method resulted in a 1% increase in Accrued Liabilities.

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

***Retirement age for active employees*** – Based on assumptions used by the Office of the State Actuary in Olympia, Washington but adjusted to reflect expected future rates of retirement based on current experience of the District.

***Mortality*** – Rates of mortality are the same that were used for PERS participants in the June 30, 2012 actuarial valuation published by the Office of the State Actuary.

***Medical trends*** – Premium increases of 7.5% in 2014 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 District's current long term borrowing rate. This rate is used because the Plan is "unfunded" and the District's assets would be used to pay benefits.

# **PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON**

## **NOTES TO THE FINANCIAL STATEMENTS**

**DECEMBER 31, 2013 AND 2012**

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### **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 9 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, 2013, the build out is 59% complete. This fiber optic distribution system is interconnected with multiple regional and national telecommunications carriers, including NoaNet’s fiber optic network. The District has made capacity on this system available to providers of high speed Internet services and telephone services, among others.

# PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

## NOTES TO THE FINANCIAL STATEMENTS DECEMBER 31, 2013 AND 2012

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A summary of the results of operations of the wholesale fiber optic network activities, and its utility plant balances and related additions, as of and for the years ended December 31, are as follows:

(amounts in thousands)	2013	2012
Operating revenues		
Wholesale fiber services	\$ 4,027	\$ 3,439
Dark fiber revenue	<u>377</u>	<u>394</u>
Wholesale fiber optic network sales	<u>\$ 4,404</u>	<u>\$ 3,833</u>
Operating expenses		
Administrative and general	\$ 431	\$ 458
Repairs and maintenance	1,038	832
Depreciation	<u>5,499</u>	<u>6,065</u>
Total operating expenses	<u>\$ 6,968</u>	<u>\$ 7,355</u>
Nonoperating revenues		
Contributions in aid of construction	\$ 274	\$ 100
Utility plant		
Additions to utility plant	\$ 11,254	\$ 11,235
Utility plant, net of accumulated depreciation	\$ 83,576	\$ 77,752

### 12. SUBSEQUENT EVENT

On February 27, 2014, the District discovered a fracture on one of the twelve monoliths comprising the spillway section of the Wanapum dam. As a precaution, the reservoir behind the dam was lowered to relieve pressure on the affected monolith and to investigate the cause of the fracture. The scope and specifics of the repairs are still being determined and may vary depending on results of the on-going investigation. However, as of April 22, 2014, the District announced a preliminary estimate of \$61 million that may ultimately be incurred in connection with the investigation and repairs associated with this matter.

Further, management has not determined how long and at what sustained levels the drawdown will need to be maintained; however, at the current drawdown elevation levels of 541-545 feet above sea level, generation capability has decreased by 40-50%. Included in the cost estimate described above is approximately \$8 million in replacement power costs associated with these lower generation levels. Favorable regional water levels and stable wholesale revenue

# **PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON**

## **NOTES TO THE FINANCIAL STATEMENTS DECEMBER 31, 2013 AND 2012**

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contracts mitigate the impact of curtailment. Current generation levels are expected to be sufficient to meet distribution system expectations.

### **13. 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 statements 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. 2012 information is restated to reflect changes in accounting principles per GASB 65.

# PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

## NOTE 13 - SEGMENTS DECEMBER 31, 2013

### CONDENSED STATEMENT OF NET POSITION

(AMOUNTS IN THOUSANDS)	Electric System	Priest Rapids Project	Other	Total
<b>ASSETS</b>				
Total current assets	\$ 237,027	\$ 83,042	\$ (53,652)	\$ 266,417
Net utility plant	534,790	1,154,571	-	1,689,361
Noncurrent	81,615	156,729	501	238,845
TOTAL ASSETS	853,432	1,394,342	(53,151)	2,194,623
Deferred outflows of resources	1,035	6,299	-	7,334
<b>TOTAL ASSETS AND DEFERRED OUTFLOWS OF RESOURCES</b>	<b>\$ 854,467</b>	<b>\$ 1,400,641</b>	<b>\$ (53,151)</b>	<b>\$ 2,201,957</b>
<b>LIABILITIES</b>				
Current	\$ 86,004	\$ 117,560	\$ (53,151)	\$ 150,413
Noncurrent	158,253	1,043,326	-	1,201,579
TOTAL LIABILITIES	244,257	1,160,886	(53,151)	1,351,992
<b>NET POSITION</b>				
Invested in capital assets, net of related debt	373,716	156,712	-	530,428
Restricted	24,465	82,991	-	107,456
Unrestricted	212,029	52	-	212,081
TOTAL NET POSITION	610,210	239,755	-	849,965
<b>TOTAL LIABILITIES AND NET POSITION</b>	<b>\$ 854,467</b>	<b>\$ 1,400,641</b>	<b>\$ (53,151)</b>	<b>\$ 2,201,957</b>

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

# PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

## NOTE 13 - SEGMENTS FOR THE YEAR ENDED DECEMBER 31, 2013

### SCHEDULE OF REVENUES, EXPENSES AND CHANGES IN NET POSITION

(AMOUNTS IN THOUSANDS)	Electric System	Priest Rapids Project	Other	Total
OPERATING REVENUES	\$ 234,786	\$ 142,168	\$ (86,527)	\$ 290,427
OPERATING EXPENSES				
Depreciation and amortization	29,612	20,862	-	50,474
Other operating expenses	171,552	66,010	(86,527)	151,035
Total operating expenses	201,164	86,872	(86,527)	201,509
NET OPERATING INCOME	33,622	55,296	-	88,918
OTHER REVENUES (EXPENSES)				
Interest and other income	(96)	(140)	-	(236)
Interest on revenue bonds and other, net of capitalized interest	(4,725)	(39,071)	-	(43,796)
Federal rebates on revenue bonds	-	7,712	-	7,712
Amortization of debt expense, discount, and premium	1,917	235	-	2,152
Total other revenues (expenses)	(2,904)	(31,264)	-	(34,168)
CONTRIBUTIONS IN AID OF CONSTRUCTION	11,966	-	-	11,966
CHANGE IN NET POSITION	42,684	24,032	-	66,716
NET ASSETS				
Beginning of year	567,524	215,725	-	783,249
End of year	\$ 610,208	\$ 239,757	\$ -	\$ 849,965

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

## PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

### NOTE 13 - SEGMENTS FOR THE YEAR ENDED DECEMBER 31, 2013

#### CONDENSED SCHEDULE OF CASH FLOWS

(AMOUNTS IN THOUSANDS)	Electric System	Priest Rapids Project	Other	Total
Net cash provided by operating activities	\$ 66,412	\$ 76,200	\$ 17,251	\$ 159,863
Net cash provided by (used in) capital and related financing activities	(57,072)	(119,068)	(566)	(176,706)
Net cash (used in) provided by investing activities	(5,257)	35,480	(5,533)	24,690
<b>NET (DECREASE) INCREASE IN CASH</b>	<b>\$ 4,083</b>	<b>\$ (7,388)</b>	<b>\$ 11,152</b>	<b>\$ 7,847</b>
CASH AT END OF PERIOD	\$ 17,815	\$ 7,946	\$ 7,269	\$ 33,030
CASH AT BEGINNING OF YEAR	13,732	15,334	(3,883)	25,183
<b>NET (DECREASE) INCREASE IN CASH</b>	<b>\$ 4,083</b>	<b>\$ (7,388)</b>	<b>\$ 11,152</b>	<b>\$ 7,847</b>

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



# PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

## NOTE 13 - SEGMENTS DECEMBER 31, 2012 (RESTATED)

### CONDENSED STATEMENT OF NET POSITION

(AMOUNTS IN THOUSANDS)	Electric System	Priest Rapids Project	Other	Total
<b>ASSETS</b>				
Total current assets	\$ 155,062	\$ 96,926	\$ (23,875)	\$ 228,113
Net utility plant	495,034	1,020,505	-	1,515,539
Noncurrent	112,530	186,683	-	299,213
<b>TOTAL ASSETS</b>	<b>762,626</b>	<b>1,304,114</b>	<b>(23,875)</b>	<b>2,042,865</b>
Deferred outflows of resources	30	7,723	-	7,753
<b>TOTAL ASSETS AND DEFERRED OUTFLOWS OF RESOURCES</b>	<b>\$ 762,656</b>	<b>\$ 1,311,837</b>	<b>\$ (23,875)</b>	<b>\$ 2,050,618</b>
<b>LIABILITIES</b>				
Current	\$ 36,134	\$ 129,766	\$ (23,875)	\$ 142,025
Noncurrent	158,997	966,347	-	1,125,344
<b>TOTAL LIABILITIES</b>	<b>195,131</b>	<b>1,096,113</b>	<b>(23,875)</b>	<b>1,267,369</b>
<b>NET ASSETS</b>				
Invested in capital assets, net of related debt	381,156	141,494	-	522,650
Restricted	24,626	70,425	-	95,051
Unrestricted	161,743	3,805	-	165,548
<b>TOTAL NET ASSETS</b>	<b>567,525</b>	<b>215,724</b>	<b>-</b>	<b>783,249</b>
<b>TOTAL LIABILITIES AND NET ASSETS</b>	<b>\$ 762,656</b>	<b>\$ 1,311,837</b>	<b>\$ (23,875)</b>	<b>\$ 2,050,618</b>

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

# PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

## NOTE 13 - SEGMENTS DECEMBER 31, 2012 (RESTATED)

### 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 (LOSS) 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	(6,792)	(44,572)	-	(51,364)
Federal rebates on revenue bonds	-	7,809	-	7,809
Amortization of debt expense, discount, and premium	3,376	(829)	-	2,547
Total other revenues (expenses)	(2,142)	(35,389)	-	(37,531)
CONTRIBUTIONS IN AID OF CONSTRUCTION	3,848	-	-	3,848
CHANGE IN NET POSITION	33,249	20,053	-	53,302
NET POSITION				
Beginning of year	534,276	195,671	-	729,947
End of year	\$ 567,525	\$ 215,724	\$ -	\$ 783,249

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

# PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

## NOTE 13 - SEGMENTS DECEMBER 31, 2012 (RESTATED)

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### CONDENSED SCHEDULE OF CASH FLOWS

(AMOUNTS IN THOUSANDS)	Electric System	Priest Rapids Project	Other	Total
Net cash provided by operating activities	\$ 57,982	\$ 78,460	\$ (2,996)	\$ 133,446
Net cash (used in) provided by capital and related financing activities	(52,828)	(113,271)	(7,016)	(173,115)
Net cash provided by (used in) investing activities	857	37,847	8,524	47,228
NET (DECREASE) INCREASE IN CASH	<u>\$ 6,011</u>	<u>\$ 3,036</u>	<u>\$ (1,488)</u>	<u>\$ 7,559</u>
CASH AT END OF PERIOD	\$ 13,732	\$ 15,334	\$ (3,883)	\$ 25,183
CASH AT BEGINNING OF YEAR	<u>7,721</u>	<u>12,298</u>	<u>(2,395)</u>	<u>17,624</u>
NET (DECREASE) INCREASE 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)

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## APPENDIX D

### 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  
Priest Rapids Hydroelectric Project Revenue and Refunding Bonds, 2014  
Series A — \$150,725,000  
Series B (AMT) — \$53,440,000

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 Priest Rapids Hydroelectric Project Revenue and Refunding Bonds, 2014 Series A, in the aggregate principal amount of \$150,725,000 (the “2014A Bonds”) and Priest Rapids Hydroelectric Project Revenue Refunding Bonds, 2014 Series B (AMT), in the aggregate principal amount of \$53,440,000 (the “2014B Bonds,” and, together with the 2014A Bonds, 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. 8747 of the District’s Board of Commissioners (the “Bond Resolution”) to finance improvements to the Priest Rapids Project, to refund certain outstanding bonds, to fund the Reserve Account and to pay all or a portion of the costs of issuance of the Bonds.

The District has irrevocably bound itself to set aside and pay into the Bond Fund and the Reserve Account therein out of Gross Revenue (defined below), amounts necessary to pay the principal of and interest on the Bonds as the same becomes due.

The District has pledged that the payments to be made into the Bond Fund and the Reserve Account out of the Gross Revenue shall be a lien and charge thereon equal in rank to the lien and charge upon the revenue of the amounts required to pay and secure the payment of the Outstanding Parity Bonds, and superior to all other liens and charges, except the Operating Expenses. The District has reserved the right to issue Future Parity Bonds on the terms set forth in the Bond Resolution.

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

We express no opinion herein concerning the completeness or accuracy of any official statement, offering circular or other sales or disclosure material relating to the issuance of the Bonds or otherwise used in connection with the Bonds.

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 money and assets, if any, credited to the Revenue Fund, the Bond Fund, the Project Account and the RR&C Fund, and the income therefrom, and (ii) the Gross Revenues, subject to prior application to pay Operating Expenses (as such terms are defined 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 (except any 2014B Bond for any period during which it is held by a “substantial user” of the facilities being financed by the 2014B Bonds or by a “related person” within the meaning of Section 147(a) of the Code) is excluded from gross income for federal income tax purposes. Interest on the 2014A Bonds is not an item of tax preference under the Code and is not subject to the federal alternative minimum tax applicable to individuals. However, interest on the 2014A 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 2014B Bonds received by individuals and corporations will constitute an item of tax preference for purposes of the federal alternative minimum tax applicable to individuals and corporations. In addition, 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.

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.

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,

FOSTER PEPPER PLLC

## APPENDIX E

### 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](http://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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