

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 2012A Bonds, interest on the 2012A Bonds is excluded from gross income for federal income tax purposes and is not an item of tax preference for purposes of the alternative minimum tax applicable to individuals. However, while interest on the 2012A Bonds also is not an item of tax preference for purposes of the alternative minimum tax applicable to corporations, interest on the 2012A Bonds received by corporations is taken into account in the computation of adjusted current earnings for purposes of the alternative minimum tax applicable to corporations, interest on the 2012A Bonds received by certain S corporations may be subject to tax, and interest on the 2012A Bonds received by foreign corporations with United States branches may be subject to a foreign branch profits tax. Receipt of interest on the 2012A Bonds may have other federal tax consequences for certain taxpayers. See “TAX MATTERS—The 2012A Bonds.”

In the opinion of Bond Counsel, under existing federal law and assuming compliance with applicable requirements of the Code that must be satisfied subsequent to the issue date of the 2012B Bonds, interest on the 2012B Bonds (except any 2012B 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. However, interest on the 2012B 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, interest on the 2012B Bonds received by certain S corporations may be subject to tax, and interest on the 2012B Bonds received by foreign corporations with United States branches may be subject to a foreign branch profits tax. Receipt of interest on the 2012B Bonds may have other federal tax consequences for certain taxpayers. See “TAX MATTERS—The 2012B Bonds.”

In the further opinion of Bond Counsel, interest on the 2012M Bonds and 2012Z Bonds is not excludable from gross income under Section 103 of the Code. See “TAX MATTERS—The 2012M Bonds and 2012Z Bonds.”



**PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON
PRIEST RAPIDS HYDROELECTRIC PROJECT
REVENUE AND REFUNDING BONDS, 2012**

\$54,510,000	\$16,235,000
Series A (Not Subject to AMT)	Series B (Subject to AMT)
\$42,395,000	\$14,480,000
Series M (Taxable New Clean Renewable Energy Bonds – Direct Payment)	Series Z (Taxable)

Bonds Dated: Date of Delivery **Due: January 1, as shown on the inside cover pages**

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

Interest on the Bonds, first payable on January 1, 2013, 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 revenue bonds of the District. 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 \$889,875,000 (of which \$88,555,000 will be refunded with proceeds of the Bonds; see “PURPOSE AND APPLICATION OF BOND PROCEEDS—Purpose 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.”

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 in the inside cover pages.

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, and their counsel—tax matters, Orrick, Herrington & Sutcliffe LLP, San Francisco, California. The Bonds are expected to be delivered on or about June 14, 2012, through the facilities of DTC in New York, New York, by Fast Automated Securities Transfer.

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

**\$54,510,000
Revenue Refunding Bonds, 2012 Series A
(Not Subject to AMT)**

Maturity (January 1)	Amount	Interest Rate	Initial Reoffering Yield	CUSIP No.*
2013	\$ 525,000	2.00%	0.30%	387883RW3
2014	2,440,000	5.00	0.48	387883RX1
2015	2,565,000	5.00	0.70	387883RY9
2016	2,695,000	5.00	0.88	387883RZ6
2017	2,835,000	5.00	1.11	387883SA0
2018	3,090,000	5.00	1.40	387883SB8
2019	4,645,000	5.00	1.66	387883SC6
2020	4,875,000	5.00	1.97	387883SD4
2021	5,115,000	5.00	2.24	387883SE2
2022	3,285,000	5.00	2.43	387883SF9
2023	3,460,000	5.00	2.61**	387883SG7
2024	2,330,000	5.00	2.76**	387883SH5
2025	2,445,000	5.00	2.88**	387883SJ1
2026	2,570,000	5.00	2.96**	387883SK8
2027	2,700,000	5.00	3.04**	387883SM4
2028	2,840,000	5.00	3.12**	387883SN2
2029	2,980,000	5.00	3.19**	387883SP7

\$1,635,000 5.00% Term Bond due January 1, 2035, initial reoffering yield of 3.45%**; CUSIP No. 387883SL6*

\$1,480,000 3.75% Term Bond due January 1, 2035, initial reoffering yield of 3.95%; CUSIP No. 387883SQ5*

**\$16,235,000
Revenue Refunding Bonds, 2012 Series B
(Subject to AMT)**

Maturity (January 1)	Amount	Interest Rate	Initial Reoffering Yield	CUSIP No.*
2013	\$ 745,000	2.00%	0.65%	387883SR3
2014	1,230,000	5.00	0.85	387883SS1
2015	1,285,000	5.00	1.07	387883ST9
2016	1,355,000	5.00	1.26	387883SU6
2017	1,425,000	5.00	1.51	387883SV4
2018	1,500,000	5.00	1.81	387883SW2
2019	1,580,000	5.00	2.09	387883SX0
2020	1,655,000	5.00	2.40	387883SY8
2021	1,730,000	5.00	2.67	387883SZ5
2022	1,825,000	5.00	2.83	387883TA9
2023	1,905,000	5.00	2.98**	387883TB7

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

** Priced to the July 1, 2022 par call date.

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

\$42,395,000
Revenue Bonds, 2012 Series M
(Taxable New Clean Renewable Energy Bonds – Direct Payment)

Maturity (January 1)	Amount	Interest Rate	Initial Reoffering Price	CUSIP No.*
2032	\$42,395,000	3.914%	100.00%	387883RD5

\$14,480,000
Revenue Refunding Bonds, 2012 Series Z
(Taxable)

Maturity (January 1)	Amount	Interest Rate	Initial Reoffering Price	CUSIP No.*
2013	\$ 130,000	0.55%	100.00%	387883RE3
2014	505,000	0.75	100.00	387883RF0
2015	515,000	1.36	100.00	387883RG8
2016	520,000	1.49	100.00	387883RH6
2017	525,000	1.79	100.00	387883RJ2
2018	525,000	2.01	100.00	387883RK9
2019	535,000	2.31	100.00	387883RL7
2020	560,000	2.62	100.00	387883RM5
2021	575,000	2.77	100.00	387883RN3
2022	580,000	2.92	100.00	387883RP8
2023	615,000	3.07	100.00	387883RQ6
2024	600,000	3.32	100.00	387883RR4
2025	620,000	3.47	100.00	387883RS2
2026	640,000	3.62	100.00	387883RT0
2027	660,000	3.72	100.00	387883RU7

\$6,375,000 4.164% Term Bond due January 1, 2035, at a price of 100.00%; CUSIP No. 387883RV5*

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

[THIS PAGE INTENTIONALLY LEFT BLANK]

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.

In connection with the offering of the Bonds, the Underwriters may over allot or effect transactions which stabilize or maintain the market price of such Bonds at levels above that which might otherwise prevail in the open market. Such stabilizing, if commenced, may be discontinued at any time.

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.

No action has been taken by the District that would permit a public offering of the Bonds or possession or distribution of this Official Statement or any other offering material in any foreign jurisdiction where action for that purposes is required. Accordingly, each of the Underwriters has agreed that it will comply with all applicable laws and regulations in force in any foreign jurisdiction in which it purchases, offers or sells the Bonds or possesses or distributes this Official Statement or any other offering material and will obtain any consent, approval or permission required by it for the purchase, offer or sale by it of the Bonds under the laws and regulations in force in any foreign jurisdiction to which it is subject to or in which it makes such purchases, offers or sales and the District shall have no responsibility therefor.

PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY
30 "C" Street S.W.
Ephrata, Washington 98823
(509) 754-0500
www.gcpud.org*

Commissioners

Thomas W. Flint..... President
Terry Brewer Vice President
Bob Bernd..... Secretary
Randall M. Allred Commissioner
Dale Walker..... Commissioner

Senior Management

Tim Culbertson..... General Manager
Joe Lukas Senior Policy Advisor
Chuck Berrie..... Assistant General Manager
Kevin Nordt..... Chief Financial Officer
Anthony Webb..... Assistant General Manager
Mitch Delabarre..... General Counsel
Kim Justice Auditor
Mary Kunkle..... Treasurer
Jeff Grizzel Director of Natural Resources
Debbie Lowe Director of Support Services
Andrew Munro Director of Customer Service
Dawn Woodward..... Director of Hydro
Bonnie Overfield..... Director of Finance and Accounting

Bond and Disclosure Counsel

Foster Pepper PLLC
Seattle, Washington

Paying Agent and Registrar

The Bank of New York Mellon
New York, New York

Bond Trustee

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

* 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.

TABLE OF CONTENTS

	Page		Page
INTRODUCTION	1	FERC License	30
PURPOSE AND APPLICATION OF BOND		Yakama Nation Agreement	31
PROCEEDS	2	Regulatory Proceedings Affecting the	
Purpose of the Bonds	2	Developments	32
Application of the Bond Proceeds	4	Rehabilitation Program – Priest Rapids Project	34
DESCRIPTION OF THE BONDS	4	Estimated Capital and Financing Requirements	36
General Terms	4	Future Borrowings	36
Designation of 2012M Bonds as “New Clean		Operating Results	36
Renewable Energy Bonds”	5	Debt Service Requirements for the Priest Rapids	
Termination of Book-Entry Transfer System	6	Project	38
Transfer and Exchange	6	THE ELECTRIC SYSTEM	38
Optional Redemption	6	Retail Energy Sales and Customers	39
Extraordinary Optional Redemption – 2012M		Power Supply Management and Power Marketing	41
Bonds	7	Rates	43
Mandatory Redemption	8	The Electric System’s Power Supply	45
Sinking Fund Payments--2012M Bonds	9	Future Resources	48
Partial Redemption	9	Legislation and Initiatives	48
Notice of Redemption	10	Telecommunications	49
Open Market Purchases	10	Outstanding Long-Term Debt of the District	50
Defeasance of the Bonds	10	Electric System Operating Results	51
SECURITY FOR THE PARITY BONDS	11	Management’s Discussion of Results	52
Pledge of Revenues; Consolidation of		Capital Requirements	53
Developments	11	Various Factors Affecting the Electric Utility	
Obligations of the Electric System	12	Industry	54
Flow of Funds	12	ECONOMIC AND DEMOGRAPHIC	
Limited Obligations	13	INFORMATION	54
Rate Covenants	13	LITIGATION	58
Reserve Account	13	INITIATIVE AND REFERENDUM	58
RR&C Fund	15	LIMITATIONS ON REMEDIES	59
Future Parity Bonds	15	TAX MATTERS	59
Derivative Products	16	The 2012A Bonds	59
Contingent Payment Obligations	16	The 2012B Bonds	61
No Acceleration Upon Default	16	The 2012M Bonds and 2012Z Bonds	63
THE DISTRICT	17	ERISA CONSIDERATIONS	64
General	17	CERTAIN LEGAL MATTERS	65
Management and Administration	19	UNDERWRITING	65
Accounting and Financial Statements	21	CONTINUING DISCLOSURE	66
District Employees and Retirement Plans and		Prior Compliance with Continuing Disclosure	
Other Post-Employment Benefits	21	Undertakings	68
Insurance	22	RATINGS	68
Strategic Planning and Financial Policies	22	MISCELLANEOUS	69
Investments	23	APPENDIX A	SUMMARY OF CERTAIN PROVISIONS
Hazardous Waste Issues	23	APPENDIX B	SUMMARY OF CERTAIN PROVISIONS
Security Efforts at the District	24	APPENDIX C	AUDITED FINANCIAL STATEMENTS
THE PRIEST RAPIDS PROJECT	24	APPENDIX D	OF THE DISTRICT AS OF
Description	24	APPENDIX E	DECEMBER 31, 2011 AND 2010
The Priest Rapids Development	24		PROPOSED FORM OF OPINION OF
The Wanapum Development	24		BOND COUNSEL
Energy Production	24		BOOK-ENTRY SYSTEM
Power Sales Contracts	25		
Sale of Reasonable Portion	27		
Priest Rapids Project Output	28		
Coordination Agreements	29		
Transmission of Power from Priest Rapids Project	29		

LIST OF TABLES

		Page
Table 1	PRIEST RAPIDS PROJECT HISTORICAL ENERGY PRODUCTION.....	25
Table 2	PARTICIPATION IN COSTS OF PRIEST RAPIDS PROJECT 2011	26
Table 3	REASONABLE PORTION AUCTION WINNERS	27
Table 4	PRIEST RAPIDS PROJECT HISTORICAL ENERGY SALES (MWh).....	28
Table 5	PRIEST RAPIDS HYDROELECTRIC PROJECT 2012-2014 FORECAST CAPITAL PROGRAM EXPENDITURES.....	36
Table 6	PRIEST RAPIDS PROJECT OPERATING RESULTS	37
Table 7	PRIEST RAPIDS PROJECT TOTAL DEBT SERVICE REQUIREMENTS	38
Table 8	ELECTRIC SYSTEM 2011 RETAIL CUSTOMERS, ENERGY SALES AND REVENUES	39
Table 9	ELECTRIC SYSTEM LARGEST CUSTOMERS	39
Table 10	ELECTRIC SYSTEM RETAIL CUSTOMERS, ENERGY SALES, AND REVENUES	40
Table 11	ELECTRIC SYSTEM WHOLESALE ENERGY SALES.....	42
Table 12	ELECTRIC SYSTEM MONTHLY ELECTRIC BILLS COMPARISON	44
Table 13	ELECTRIC SYSTEM RECENT RETAIL RATE INCREASES	45
Table 14	SUMMARY OF OUTSTANDING LONG TERM DEBT OF THE DISTRICT	50
Table 15	ELECTRIC SYSTEM HISTORICAL OPERATING RESULTS	51
Table 16	ELECTRIC SYSTEM HISTORICAL ENERGY REQUIREMENTS, RESOURCES AND POWER COSTS	52
Table 17	ELECTRIC SYSTEM PROJECTED CAPITAL IMPROVEMENTS PROGRAM 2012-2014.....	53
Table 18	GRANT COUNTY SELECTED ECONOMIC INDICATORS.....	55
Table 19	GRANT COUNTY MAJOR PROPERTY TAXPAYERS	56
Table 20	GRANT COUNTY MAJOR EMPLOYERS	57
Table 21	GRANT COUNTY RESIDENT CIVILIAN LABOR FORCE AND EMPLOYMENT.....	57
Table 22	GRANT COUNTY NONAGRICULTURAL EMPLOYMENT.....	58

PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

OFFICIAL STATEMENT

RELATING TO

\$54,510,000

**PRIEST RAPIDS HYDROELECTRIC PROJECT
REVENUE REFUNDING BONDS, 2012 SERIES A
(NOT SUBJECT TO AMT)**

\$16,235,000

**PRIEST RAPIDS HYDROELECTRIC PROJECT
REVENUE REFUNDING BONDS, 2012 SERIES B
(SUBJECT TO AMT)**

\$42,395,000

**PRIEST RAPIDS HYDROELECTRIC PROJECT
REVENUE BONDS, 2012 SERIES M
(TAXABLE NEW CLEAN RENEWABLE ENERGY BONDS – DIRECT PAYMENT)**

AND

\$14,480,000

**PRIEST RAPIDS HYDROELECTRIC PROJECT
REVENUE REFUNDING BONDS, 2012 SERIES Z
(TAXABLE)**

INTRODUCTION

The purpose of this Official Statement, which includes the cover page, inside cover pages 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 \$54,510,000 principal amount of Priest Rapids Hydroelectric Project Revenue Refunding Bonds, 2012 Series A (Not Subject to AMT) (the “2012A Bonds”), \$16,235,000 principal amount of Priest Rapids Hydroelectric Project Revenue Refunding Bonds, 2012 Series B (Subject to AMT) (the “2012B Bonds”), \$42,395,000 principal amount of Priest Rapids Hydroelectric Project Revenue Bonds, 2012 Series M (Taxable New Clean Renewable Energy Bonds – Direct Payment) (the “2012M Bonds”), and \$14,480,000 principal amount of Priest Rapids Hydroelectric Project Revenue Refunding Bonds, 2012 Series Z (Taxable) (the “2012Z Bonds,” and together with the 2012A Bonds, the 2012B Bonds, and the 2012M 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. 8625 of the District, adopted on May 14, 2012 (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 \$12,335,000 principal amount of its Priest Rapids Hydroelectric Development Second Series Revenue Refunding Bonds, 2001 Series B (the “2001 Priest Rapids Bonds”), \$31,290,000 principal amount of its Priest Rapids Hydroelectric Development Second

Series Revenue Bonds, 2003 Series A and 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”), \$18,750,000 principal amount of its Wanapum Hydroelectric Development Second Series Revenue Refunding Bonds, 1999 Series D (the “1999 Wanapum D Bonds”), \$16,465,000 principal amount of its Wanapum Hydroelectric Development Second Series Revenue Refunding Bonds, 2001 Series B (the “2001 Wanapum Bonds”), \$57,280,000 principal amount of its Wanapum Hydroelectric Development Second Series Revenue Bonds, 2003 Series A, B and 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”), and \$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”). The 2001 Priest Rapids Bonds, 2003 Priest Rapids Bonds, 2005 Priest Rapids Bonds and 2006 Priest Rapids Bonds, 1999 Wanapum D Bonds, 2001 Wanapum Bonds, 2003 Wanapum Bonds, 2005 Wanapum Bonds, 2006 Wanapum Bonds and 2010 Priest Rapids Project Bonds are referred to as the “Outstanding Parity Bonds,” and 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 \$889,875,000 (of which \$88,555,000 will be refunded with proceeds of certain of the Bonds). See “PURPOSE AND APPLICATION OF BOND PROCEEDS—Purpose of the Bonds.” **For a summary of currently Outstanding Parity Bonds, see Table 14.**

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

PURPOSE AND APPLICATION OF BOND PROCEEDS

Purpose of the Bonds

The Bonds are being issued to finance improvements to the Priest Rapids Project, refund certain outstanding revenue bonds of the District, fund the Reserve Account and pay costs of issuance of the Bonds. Proceeds of the 2012A Bonds, 2012B Bonds and 2012Z Bonds will be used to refund certain outstanding revenue bonds of the District, as described below, to fund the Reserve Account and pay costs of issuing the 2012A Bonds, the 2012B Bonds and the 2012Z Bonds. Proceeds of the 2012M Bonds will be used to finance capital improvements to the Wanapum Development as described in the District’s application to the United States Treasury for a portion of the New Clean Renewable Energy Bond allocation and to pay costs of issuing the 2012M Bonds.

Refunding Plan

In order to effect debt service savings, the following bonds (the “Refunded Bonds”) will be refunded with the proceeds of the 2012A Bonds, 2012B Bonds and 2012Z Bonds.

Refunded Bonds

<u>Series</u>	<u>Principal Amounts</u>	<u>Interest Rates</u>	<u>Maturities</u>	<u>Redemption Dates</u>	<u>Price</u>
Priest Rapids 2001B	\$ 8,220,000	5.00%	2013-2018, 2023	July 16, 2012	100%
Priest Rapids 2003A	7,355,000	4.10-4.75	2014-2021	January 1, 2013	100
Wanapum 1999D	12,060,000	4.85-5.20	2013-2018, 2023	July 16, 2012	100
Wanapum 2001B	10,980,000	5.00	2013-2018, 2023	July 16, 2012	100
Wanapum 2003A	14,365,000	4.10-5.00	2014-2021, 2035	January 1, 2013	100
Wanapum 2003B	13,730,000	4.75-5.00	2017, 2022, 2027, 2035	January 1, 2013	100
Wanapum 2005A	21,845,000	5.00	2018*-2024, 2029	January 1, 2015	100

* Partial maturity.

A portion of the net proceeds from the sale of the 2012A Bonds, 2012B Bonds and 2012Z Bonds will be deposited in the 2012 Refunding Account (the “Refunding Account”) and used to purchase Escrow Obligations (as defined below) to be held by The Bank of New York Mellon Trust Company, N.A. (the “Escrow Agent”) under an escrow agreement (the “Escrow Agreement”), dated the date of delivery of the Bonds, between the District and the Escrow Agent. Funds will be irrevocably deposited in the Refunding Account and will be used to purchase direct, noncallable, obligations of the United States of America (the “Escrow Obligations”). The Escrow Obligations will mature at such times and pay interest in such amounts so that, with other available funds held by the Escrow Agent under the Escrow Agreement, sufficient money will be available to pay the interest on the Refunded Bonds coming due on and prior to their respective 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 Causey Demgen & Moore Inc. stating that the Escrow 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 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 2012A Bonds and 2012B 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	2012A Bonds	2012B Bonds	2012M Bonds	2012Z Bonds	Total
Par Amount of Bonds	\$ 54,510,000	\$ 16,235,000	\$ 42,395,000	\$ 14,480,000	\$ 127,620,000
Net Original Issue Premium	9,343,342	2,397,530	0	0	11,740,872
Transfer of 2012Z Bond Proceeds	0	227,543	0	0	227,543
Bond Fund	1,384,109	962,500	0	261,365	2,607,974
Total	\$ 65,237,451	\$ 19,822,573	\$ 42,395,000	\$ 14,741,365	\$ 142,196,389

Uses	2012A Bonds	2012B Bonds	2012M Bonds	2012Z Bonds	Total
Deposit to the Project Account	\$ 0	\$ 0	\$ 42,051,592	\$ 0	\$ 42,051,592
Deposit to the Refunding Account	60,023,188	19,718,998	0	14,398,791	94,140,977
Deposit to the Reserve Account	4,812,073	0	0	0	4,812,073
Transfer of 2012Z Bond Proceeds	0	0	0	227,543	227,543
Underwriters' Discount and Costs of Issuance (1)	402,190	103,575	343,408	115,031	964,204
Total	\$ 65,237,451	\$ 19,822,573	\$ 42,395,000	\$ 14,741,365	\$ 142,196,389

(1) Includes underwriters' discount, bond counsel fees, rating fees, legal fees, escrow agent fees, and verification agent fees and costs of posting and printing the official statement.

DESCRIPTION OF THE BONDS

General Terms

The 2012A Bonds will be issued in the aggregate principal amount of \$54,510,000 and will be dated the date of their delivery. The 2012A Bonds will bear interest at the rates per annum set forth on the inside cover page hereof, payable January 1, 2013, and semiannually thereafter on each January 1 and July 1, and will mature on January 1 in each year as set forth on the inside cover page hereof. Interest on the 2012A Bonds is not an item of tax preference for purposes of the federal alternative minimum tax imposed on individuals or corporations. See "TAX MATTERS—The 2012A Bonds."

The 2012B Bonds will be issued in the aggregate principal amount of \$16,235,000 and will be dated the date of their delivery. The 2012B Bonds will bear interest at the rates per annum set forth on the inside cover page hereof, payable January 1, 2013, and semiannually thereafter on each January 1 and July 1, and will mature on January 1 in each year as set forth on the inside cover page hereof. The 2012B Bonds are private activity bonds, and interest on the 2012B Bonds is a preference item for purposes of the federal alternative minimum tax imposed on individuals and corporations. See "TAX MATTERS—The 2012B Bonds."

The 2012M Bonds will be issued in the aggregate principal amount of \$42,395,000 and will be dated the date of their delivery. The 2012M Bonds will bear interest at the rates per annum set forth on the inside cover page hereof, payable January 1, 2013, and semiannually thereafter on each January 1 and July 1, and will mature on January 1 in the year set forth on the inside cover page hereof. Interest on the 2012M Bonds is not excludable from gross income for purposes of federal income taxation under Section 103 of the Code. The District will make elections so that the 2012M Bonds are treated as "New Clean Renewable Energy Bonds" and for which the District will receive a credit from the federal government. See "Designation of 2012M Bonds as 'New Clean Renewable Energy Bonds'" and "TAX MATTERS—The 2012M Bonds and 2012Z Bonds."

The 2012Z Bonds will be issued in the aggregate principal amount of \$14,480,000 and will be dated the date of their delivery. The 2012Z Bonds will bear interest at the rates per annum set forth on the inside cover page hereof, payable January 1, 2013, and semiannually thereafter on each January 1 and July 1, and will mature on January 1 in each year as set forth on the inside cover page hereof. Interest on the 2012Z Bonds is not excludable from gross income for purposes of federal income taxation under Section 103 of the Code. See “TAX MATTERS—The 2012M Bonds and 2012Z 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 in New York, New York, currently The Bank of New York Mellon, is the initial Registrar and Paying Agent for the Bonds.

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

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

Designation of 2012M Bonds as “New Clean Renewable Energy Bonds”

2012M Bonds as “New Clean Renewable Energy Bonds.” The District in 2009, as amended in January 2010, received an allocation of volume cap to issue new clean renewable energy bonds in the amount of \$132,396,565.76. The District used a portion of this volume cap allocation to issue \$90,000,000 of New Clean Renewable Energy Bonds in 2010, and the issuance of the 2012M Bonds will use the balance of that allocation. The District has made an irrevocable election to have Section 6431(f) of the Code apply to the 2012M Bonds so that the 2012M Bonds are treated as “specified tax credit bonds,” with respect to which the District will be allowed a credit payable by the United States Treasury to the District pursuant to Section 6431 of the Code. The credit allowed to the District shall be in an amount equal to the lesser of (i) the amount of interest payable on the 2012M Bonds on each interest payment date or (ii) 70% of the amount of interest which would have been payable on the 2012M Bonds on such date if such interest were determined at the applicable credit rate determined under Section 54A(b)(3) of the Code with respect to the 2012M Bonds.

As a result of these elections, interest on the 2012M Bonds is not excludable from gross income of owners of the 2012M Bonds under Section 103 of the Code, and owners of the 2012M Bonds will not be allowed any federal tax credits as a result of ownership of or receipt of interest payments on the 2012M Bonds. See “TAX MATTERS—The 2012M Bonds and 2012Z Bonds” herein. The obligation of the United States Treasury under Section 6431 of the Code to make direct payments to the District in respect of interest payments on the 2012M Bonds does not constitute a full faith and credit guarantee of the 2012M Bonds by the United States of America.

The Code establishes certain ongoing requirements that must be met subsequent to the delivery of the 2012M Bonds in order for the District to continue to receive federal credit payments. The Internal Revenue Service has advised that, in general, the federal credit payments made in respect of specified tax credit bonds, such as the 2012M Bonds, are to be treated as a refund of an overpayment of federal taxes against which liabilities to the federal government are required to be offset. Noncompliance by the District with applicable requirements as necessary to claim the federal credit payments, or the existence of an internal revenue tax liability of the District (such as a federal payroll tax liability) that is required to be applied as an offset against federal credit payments, may result in the District not receiving expected federal credit payments.

The federal subsidy payment is considered to be Gross Revenues under the Bond Resolution.

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.

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

2012A Bonds

The 2012A Bonds maturing on and after January 1, 2023 are subject to redemption prior to maturity, at the option of the District, in whole or in part on July 1, 2022, or any date thereafter, at 100% of the principal amount thereof, plus accrued interest, if any, to the date of redemption.

2012B Bonds

The 2012B Bonds maturing on January 1, 2023 are subject to redemption prior to maturity, at the option of the District, in whole or in part on July 1, 2022, or any date thereafter, at 100% of the principal amount thereof, plus accrued interest, if any, to the date of redemption.

2012M Bonds

The 2012M Bonds are subject to redemption prior to their respective maturities at the option of the District, in whole or in part, on any Business Day, at the Make-Whole Redemption Price for the 2012M Bonds (as defined herein) determined by the Designated Investment Banker (as defined herein). The "Make-Whole Redemption Price" for the 2012M Bonds is the greater of (i) the issue price as shown on the inside cover page of this Official Statement (but not less than 100% of the principal amount of the 2012M Bonds to be redeemed), or (ii) the sum of the present values of the remaining scheduled payments of principal and interest on the 2012M Bonds to be redeemed (taking into account any mandatory sinking fund redemptions on a pro rata basis), not including any portion of those payments of interest accrued and unpaid as of the date on which the 2012M Bonds are to be redeemed, discounted to the date on which such 2012M Bonds are to be redeemed on a semi-annual basis, assuming a 360-day year consisting of twelve 30-day months, at the "Treasury Rate" (defined below) plus 25 basis points, plus accrued and unpaid interest on the 2012M Bonds to be redeemed on the redemption date.

2012Z Bonds

The 2012Z Bonds are subject to redemption prior to their respective maturities at the option of the District, in whole or in part, on any Business Day, at the Make-Whole Redemption Price for the 2012Z Bonds (as defined herein) determined by the Designated Investment Banker (as defined herein). The “Make-Whole Redemption Price” for the 2012Z Bonds is the greater of (i) the issue price as shown on the inside cover page of this Official Statement (but not less than 100% of the principal amount of the 2012Z Bonds to be redeemed), or (ii) the sum of the present values of the remaining scheduled payments of principal and interest on the 2012Z Bonds to be redeemed (taking into account any mandatory sinking fund redemptions on a pro rata basis), not including any portion of those payments of interest accrued and unpaid as of the date on which the 2012Z Bonds are to be redeemed, discounted to the date on which such 2012Z Bonds are to be redeemed on a semi-annual basis, assuming a 360-day year consisting of twelve 30-day months, at the “Treasury Rate” (defined below) plus 25 basis points, plus accrued and unpaid interest on the 2012Z Bonds to be redeemed on the redemption date.

Definitions for 2012M Bonds and 2012Z Bonds

“Treasury Rate” means, with respect to any redemption date for a particular 2012M Bond or 2012Z Bond, the rate per annum, expressed as a percentage of the principal amount, equal to the semi-annual equivalent yield to maturity or interpolated maturity of the Comparable Treasury Issue (defined below), assuming that the Comparable Treasury Issue is purchased on the redemption date for a price equal to the Comparable Treasury Price (defined below), as calculated by the Designated Investment Banker (defined below).

“Comparable Treasury Issue” means, with respect to any redemption date for a particular 2012M Bond or 2012Z Bond, the U.S. Treasury security or securities selected by the Designated Investment Banker with an actual or interpolated maturity comparable to the remaining average life of the 2012M Bonds or 2012Z Bonds to be redeemed and that would be utilized in accordance with customary financial practice in pricing new issues of debt securities of comparable maturity to the remaining average life of such 2012M Bonds or 2012Z Bonds to be redeemed.

“Comparable Treasury Price” means, with respect to any redemption date for a particular 2012M Bond or 2012Z Bond, (i) if the Designated Investment Banker receives at least five Reference Treasury Dealer Quotations (defined below), the average of such quotations for such redemption date, after excluding the highest and lowest such Reference Treasury Dealer Quotations, or (ii) if the Designated Investment Banker obtains fewer than five Reference Treasury Dealer Quotations, the average of all such quotations.

“Designated Investment Banker” means one of the Reference Treasury Dealers appointed by the District.

“Reference Treasury Dealer” means each of five firms, specified by the District from time to time, that are primary U.S. Government securities dealers in the City of New York (each, a “Primary Treasury Dealer”); provided, however, that if any of them ceases to be a Primary Treasury Dealer, the District will substitute another Primary Treasury Dealer.

“Reference Treasury Dealer Quotations” means, with respect to each Reference Treasury Dealer and any redemption date for a particular 2012M Bond or 2012Z Bond, the average, as determined by the Designated Investment Banker, of the bid and asked prices for the Comparable Treasury Issue (expressed in each case as a percentage of its principal amount) quoted in writing to the District by such Reference Treasury Dealer at 3:30 p.m. (New York City time) on a date that is no earlier than four days prior to the date the redemption notice is mailed.

Extraordinary Optional Redemption – 2012M Bonds

The 2012M Bonds are subject to extraordinary optional redemption at any time prior to their maturity at the option of the District, in whole or in part, upon the occurrence of an Extraordinary Event, at a redemption price (the “Extraordinary Optional Redemption Price”) equal to the greater of (i) 100% of the principal amount of the 2012M Bonds to be redeemed or (ii) the sum of the present values of the remaining scheduled payments of principal and interest on the 2012M Bonds to be redeemed (taking into account any mandatory sinking fund redemptions on a pro rata basis), not including any portion of those payments of interest accrued and unpaid as of the date on which

the 2012M Bonds are to be redeemed, discounted to the date on which the 2012M Bonds are to be redeemed on a semi-annual basis, assuming a 360-day year consisting of twelve 30-day months, at the Treasury Rate (defined above) plus 100 basis points, plus, in each case, accrued and unpaid interest on the 2012M Bonds to be redeemed to the redemption date.

An “Extraordinary Event” will have occurred if (a) Section 6431 of the Code (as such Section was amended by Section 301 of the Hiring Incentives to Restore Employment Act pertaining to “New Clean Renewable Energy Bonds”) is modified or amended in a manner pursuant to which the District’s applicable cash subsidy payments from the United States Treasury are reduced or eliminated, or (b) guidance published by the Internal Revenue Service or the United States Treasury with respect to such sections places one or more substantive new conditions on the receipt by the District of such applicable cash subsidy payments and such condition(s) are unacceptable to the District.

Mandatory Redemption

The 2012A Bonds maturing on January 1, 2035 (with an interest rate of 5.00% and an interest rate of 3.75%) (which shall be deemed to be 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 2012A 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.

2012A Bonds 2035 Term Bonds (5.00% Interest Rate)

Year	Sinking Fund Installment
2030	\$ 225,000
2031	235,000
2032	250,000
2033	295,000
2034	305,000
2035*	325,000

2012A Bonds 2035 Term Bonds (3.75% Interest Rate)

Year	Sinking Fund Installment
2030	\$ 300,000
2031	310,000
2032	320,000
2033	175,000
2034	185,000
2035*	190,000

* Maturity.

The 2012Z Bonds maturing on January 1, 2035 (which shall be deemed to be 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 2012Z 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.

2012Z Bonds 2035 Term Bonds

Year	Sinking Fund Installment
2028	\$ 690,000
2029	715,000
2030	745,000
2031	775,000
2032	810,000
2033	845,000
2034	880,000
2035*	915,000

* Maturity.

Upon the purchase or redemption of 2012Z Bonds for which mandatory sinking fund installments have been established, other than by reason of the mandatory sinking fund installment redemption described above, an amount equal to the principal amount of the 2012Z Bonds so purchased or redeemed shall be credited toward each of the mandatory sinking fund installments with respect to such 2012Z Bonds of such maturity on a pro rata basis. Amounts used to purchase or redeem 2012A Bonds that are Term Bonds shall be credited against mandatory sinking fund installments by lot.

Sinking Fund Payments – 2012M Bonds

The District agrees that it will create a sinking subaccount for the 2012M Bonds and will make approximately level annual payments into such subaccount so that no later than January 1, 2032, there will be on deposit the amount required to pay principal of and interest on the 2012M Bonds; the District will periodically adjust the annual payment amounts based on the actual interest earned on investing the amounts in such subaccount so that the sinking fund subaccount is not funded at a rate more rapid than equal annual payments. Upon the purchase or redemption of 2012M Bonds for which sinking fund installments have been established, an amount equal to the principal amount of the 2012M Bonds so purchased or redeemed shall be credited toward each of the sinking fund installments with respect to such 2012M Bonds on a pro rata basis.

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 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 (except in the case of the 2012M Bonds and 2012Z Bonds), 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.

If the 2012M Bonds or 2012Z Bonds are not registered in book-entry only form, any redemption of less than all of a maturity of the 2012M Bonds or 2012Z Bonds shall be allocated among the registered owners of such 2012M Bonds or 2012Z Bonds as nearly as practicable in proportion to the principal amounts of the 2012M Bonds or 2012Z Bonds owned by each registered owner, subject to the authorized denominations applicable to the 2012M Bonds or 2012Z Bonds. This will be calculated based on the following formula:

$$\frac{(\text{principal amount to be redeemed}) \times (\text{principal amount owned by owner})}{(\text{principal amount outstanding})}$$

The particular 2012M Bonds or 2012Z Bonds to be redeemed shall be determined by the Registrar, using such method as it shall deem fair and appropriate. If the 2012M Bonds or 2012Z Bonds are registered in book-entry only form, and so long as DTC or a successor securities depository is the sole registered owner of the 2012M Bonds or 2012Z Bonds, partial redemptions will be done in accordance with DTC procedures. It is the District's intent that redemption allocations made by DTC, the DTC Participants or such other intermediaries that may exist between the District and the Beneficial Owners be made in accordance with these same proportional provisions. However, the District can provide no assurance that DTC, the DTC Participants or any other intermediaries will allocate redemptions among Beneficial Owners on such a proportional basis.

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 shall not be 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 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, shall be held by the Paying Agent so as to be available therefor on such date and if notice of redemption shall have been given as aforesaid, then, from and after the redemption date, interest on the Bonds or portions thereof so called for redemption shall 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: (i) direct obligations of, or obligations the principal of and interest on which are unconditionally guaranteed by the United States of America and bank certificates of deposit secured by such obligations; (ii) bonds, debentures, notes, participation certificates, or other obligations issued by the Banks for Cooperatives, the Federal Intermediate Credit Bank, the Federal Home Loan Bank system, the Export-Import Bank of the United States, Federal Land Banks, or the Federal National Mortgage Association; (iii) public housing bonds and project notes fully secured by contracts with the United States; and (iv) obligations of financial institutions insured by the Federal Deposit Insurance

Corporation or the Federal Savings and Loan Insurance Corporation, to the extent insured or to the extent guaranteed as permitted under any other provision of State law.

2012M Bonds and 2012Z Bonds

If the District defeases any 2012M Bonds or 2012Z Bonds, such Bonds may be deemed to be retired and “reissued” for federal income tax purposes as a result of the defeasance. See “TAX MATTERS—The 2012M Bonds and 2012Z Bonds.”

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, and the Bond Resolution, the revenues of both Developments 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 revenues of both Developments.

The Parity Bonds are special limited obligations of the District payable from and secured solely by a lien and charge on (i) 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 (ii) 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 (i) such pledge of the revenues or other money or obligations shall be valid and binding from the time made, (ii) 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 (iii) 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 (currently an amount in each month equal to .0125 of Annual Debt Service); 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.

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 of Washington, or any political subdivision of the State of Washington, or a charge upon any general fund or upon any money or other property of the District or of the State of Washington, or of any political subdivision of the State of Washington, 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 Annual Debt Service, 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, in addition to 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 2001 Priest Rapids Bonds or 2001 Wanapum Bonds are insured by Financial Security Assurance Inc., which is now known as Assured Guaranty Municipal Corp. ("FSA"), 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 ("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 Bond proceeds.

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 2001 Priest Rapids Bonds or 2001 Wanapum Bonds are insured by FSA, 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 \$18,625,900 of 2010 Priest Rapids Project Bond proceeds in the Reserve Account and obtained reserve account surety policies in the original aggregate amount of \$4,621,258.05 with Ambac Assurance Corporation (“Ambac Assurance”), surety policies in the original aggregate amount of \$1,978,509.89 with FSA, surety policies in the original aggregate amount of \$17,557,614.52 with MBIA, of which \$13,470,589 is expected to remain after January 1, 2013 (the date there are expected to be no 2003 Priest Rapids Bonds and 2003 Wanapum Bonds outstanding), and surety policies in the original aggregate amount of \$13,356,821.45 with FGIC. As of May 1, 2012, there was a balance of \$19,431,505 in the Reserve Account. Moody’s Investors Service (“Moody’s”) and Standard & Poor’s Ratings Services (“S&P”) currently rate FSA “Aa3” and “AA-,” respectively. Moody’s and S&P currently rate MBIA “B3” and “B,” respectively. Fitch Ratings (“Fitch”) has withdrawn its ratings for FSA and MBIA. Moody’s, S&P and Fitch have withdrawn their ratings for Ambac Assurance and FGIC. 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 amount in 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 Investor’s Service or Standard & Poor’s Ratings Services or their comparable recognized business successors or both Moody’s Investor’s Service or Standard & Poor’s Ratings Services 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 Assurance, 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 or of 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.

Ambac Assurance, FSA, MBIA and FGIC 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 Ambac Assurance are available on the company's website, www.ambac.com (which is not incorporated herein by this reference). Certain SEC filings of FSA are available on the company's website, www.assuredguaranty.com (which is not incorporated herein by this reference). Certain SEC filings of MBIA are available on the company's website, 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 (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 once the 2001 Priest Rapids Bonds and 2001 Wanapum Bonds are no longer Outstanding, such report will not 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 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 \$187 million in Future Parity Bonds for the Priest Rapids Project in the next two years.

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.

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 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, if any, 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 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 has the power of eminent domain.

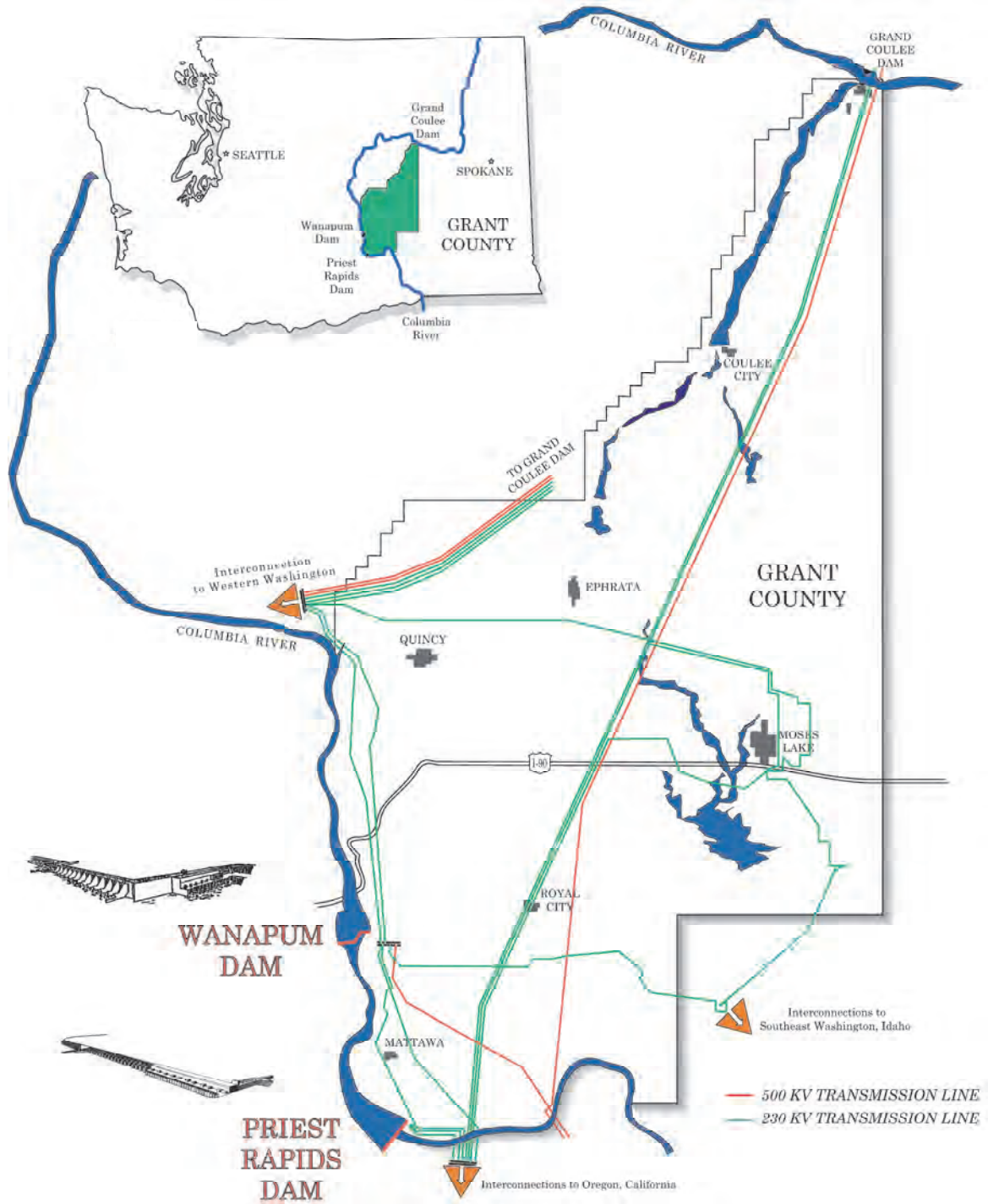
The District’s electric utility properties and operations consist of two operating systems, each of which is accounted for and financed separately. The systems are the Electric System and the Priest Rapids Project, which consists of the Priest Rapids Development and the Wanapum Development. The present combined total nameplate generating capacity of the Priest Rapids Project is approximately 2,009.6 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 and Major Transmission Lines



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)
Thomas W. Flint	President	2012
Terry Brewer	Vice President	2012
Bob Bernd	Secretary	2014
Randall M. Allred	Commissioner	2014
Dale Walker	Commissioner	2016

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

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

Bob Bernd, Secretary, 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.

Randall M. Allred, Commissioner, joined the Commission in 2003. A Grant County resident since 1962, Commissioner Allred has more than 30 years of experience in agribusiness. He is a current member of the Columbia Basin Irrigation District and has served more than 28 years on the Irrigation District's Board of Directors. Commissioner Allred, his wife Nancy, their three children and 19 grandchildren all reside and work in Grant County.

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

The senior management team of the District is as follows:

Tim Culbertson, General Manager, has been with the District since 2000. He has more than 41 years of executive management, power management and overall utility operations experience in west coast utilities. An active player in the nation's energy industry, Mr. Culbertson has testified before many Western State Commissions as well as Senate and Congressional subcommittees on energy issues. He serves on the executive committee for the Large Public Power Council, Pacific Northwest Utilities Conference Committee and the Public Generating Pool. In addition to national efforts, Mr. Culbertson is heavily involved in Northwest energy issues. He serves as a member of the executive and energy committees at the Washington Public Utility Districts Association, participates in the region's wind integration committee and holds an executive committee position with ColumbiaGrid.

Joe Lukas, Senior Policy Advisor, has worked for the District since 1995. He has more than 16 years of experience working on natural resource, relicensing and various strategic issues including financial planning and prior bond issues. Mr. Lukas served as Assistant General Manager from 2004 through 2007 and was instrumental in the District receiving a new FERC License for the Priest Rapids Project in 2008. His current work focuses on

representing the General Manager on strategic issues including regional and national initiatives affecting the District and the Priest Rapids Project. Mr. Lukas has a Bachelor of Science degree from the University of Idaho and a Master of Science degree from Virginia Tech.

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

Kevin Nordt, Chief Financial Officer, joined the District in 2004 and has nearly 20 years of experience in the Northwest energy market. In addition to his role as CFO, Mr. Nordt directs and manages the power management division. 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.

Anthony Webb, Assistant General Manager, has been with the District since 1990. He previously served as Director of Customer Service and Director of Human Resources and Support Services. In his present role, he manages the utility's support services and customer service divisions. Mr. Webb has a Bachelor of Arts degree from Eastern Washington University and experience in aerospace industrial engineering management.

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

Kim Justice, Auditor, joined the District in 1998. She is a Certified Public Accountant and holds a Bachelor of Science degree from City University. Ms. Justice has extensive experience in legal and financial audits of government agencies.

Mary Kunkle, Treasurer, joined the District in 2003 after 19 years as Treasurer/Controller at Samaritan Healthcare in Moses Lake. She has been the District's Deputy Treasurer since 2007, became the District's Treasury Operations Manager in 2009, was appointed as Interim Treasurer in July 2011 and became Treasurer in September 2011. Ms. Kunkle holds a Bachelor of Science degree from the University of Idaho.

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

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

Andrew Munro, Director of Customer Service, joined the District in 2007. He has nearly 20 years of electric industry management and government relations experience, including half of those years in public power. Mr. Munro holds a Bachelors of Arts degree from the University of Washington.

Dawn Woodward, Director of Hydro, has been with the District since 1981. She has extensive experience throughout the utility's operations and has represented the District in a wide variety of civic organizations.

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

Accounting and Financial Statements

The accounting and reporting policies of the District conform to generally accepted accounting principles for municipal governments and are regulated by the Washington State Auditor’s Office. The State Auditor’s Office has the responsibility to audit the District’s financial operations. In addition, the District’s financial statements are audited by an independent auditing firm. The District’s current independent auditor is PricewaterhouseCoopers LLP, which has been the District’s auditor since 2003. The audited financial statements of the District for the fiscal years ended December 31, 2011 and 2010 are included as a part of this Official Statement as Appendix C.

District Employees and Retirement Plans and Other Post-Employment Benefits

Following are the number of District employees by function as of March 29, 2012.

Function	Number of Regular Employees (FTE)
Manager’s Division	11
Power Management	36
HR/Safety	16
Accounting, Finance and Strategic Planning	19
Hydro Generation	241
Natural Resources	38
Support Services	91
Customer Service	179
Total	631

The District also has approximately 50 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 631 regular employees, as of March 29, 2012, 58% are bargaining unit employees under a Collective Bargaining Agreement (“CBA”) with the International Brotherhood of Electric Workers (the “IBEW”). The current IBEW three-year CBA runs through March 31, 2014. There has not been a significant labor stoppage at the District since 1978.

Pensions for the District’s employees are provided by the Washington State Public Employees Retirement System (“PERS”) through three different retirement plan options. These plans are administered by the State. The Washington State Investment Board invests the funds in the plans. PERS Plan 1 and Plan 2 are defined benefit plans. PERS Plan 3 is both a defined benefit plan (employer share) and defined contribution plan (employee share). The Priest Rapids Project’s and the Electric System’s shares of these costs are in proportion to their share of direct payroll costs. The following shows employer and employee contribution rates.

PERS Contribution Rates Expressed as a Percentage of Covered Payroll (Effective as of April 1, 2012)

	Plan 1	Plan 2	Plan 3
Employer ⁽¹⁾	7.08%	7.08%	7.08%
Employee	6.00%	4.64%	Variable ⁽²⁾

(1) Includes a 0.16% administration fee. In addition, the employer contribution rates are expected to increase on July 1, 2012 to the rate of 7.21% for each of Plan 1, Plan 2 and Plan 3.

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

While the District’s 2011 contribution of \$3,153,000, on a covered payroll of \$52,800,000, represented its full current liability under the system, any unfunded benefit obligation could be reflected in future years as higher

contribution rates. The State Actuary's website (which is not incorporated into this Official Statement by reference) includes information regarding the values and funding levels of the three PERS plans. For additional information, see Note 8 to the Audited Financial Statements for the Years Ended December 31, 2011 and 2010, attached hereto as APPENDIX C.

According to the Office of the State Actuary, as of June 30, 2010, PERS Plans 2 and 3 had no unfunded actuarial accrued liability. However, during the years 2001 through 2010 the rates adopted by the Legislature were lower than those that would have been required to produce actuarially required contributions to PERS Plan 1, a closed plan with a large proportion of the retirees. According to a report issued by the Office of the State Actuary, the total unfunded actuarial accrued liability of PERS Plan 1 is \$3.238 billion as of June 30, 2010. The assumptions used by the State Actuary in calculating the unfunded liability are an 8% annual rate of investment return, 4% general salary increases and 3.5% consumer price index increase. Liabilities were valued using the "Projected Unit Credit" cost method and assets valued using the actuarial value of assets, which defers a portion of the annual investment gains or losses over a period of up to eight years.

Assets for one plan may not be used to fund benefits for another plan; however, all employers in PERS are required to make contributions at a rate (percentage of payroll) determined by the Office of the State Actuary every two years for the sole purpose of amortizing the PERS Plan 1 unfunded actuarial accrued liability within a rolling 10-year period. The Legislature has established certain maximum contribution rates that began in 2009 and will continue until 2015 and certain minimum contribution rates that are to become effective in 2015 and remain in effect until the actuarial value of assets in PERS Plan 1 equals 100% of the actuarial accrued liability of PERS Plan 1. These rates are subject to change by future legislation enacted by the State Legislature to address future changes in actuarial and economic assumptions and investment performance. In 2011, the Legislature ended the future automatic annual increase, which is a fixed dollar amount multiplied by the member's total years of service, for most retirees in the PERS Plan 1 plan, which is forecast to reduce the unfunded accrued actuarial liability in PERS Plan 1. A lawsuit has been filed challenging this legislation. See Note 8 to the Audited Financial Statements for the Years Ended December 31, 2011 and 2010, attached hereto as APPENDIX C for a description of a deferred compensation plan administered by the District.

The District administers a single-employer defined benefit premium program that covers a portion of healthcare insurance for retirees ages 59 1/2 to 65 and their spouses. For the years ended December 31, 2011 and 2010, the District paid \$294,000 and \$206,000 in retiree subsidies. The District's net accrued other post-employment benefit obligation at the year ended December 31, 2011 was \$1,068,000. See Note 9 to the Audited Financial Statements for the Years Ended December 31, 2011 and 2010, attached hereto as APPENDIX C.

Insurance

The District carries excess liability coverage in the amount of \$60 million with a self-insured retention of \$500,000. 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 not covered by various underlying policies. The insurance reserve fund had a balance of \$1.11 million at 2011 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.

Strategic Planning and Financial Policies

The District adopted a strategic plan in May 2011 that will be reviewed annually and modified as necessary by staff and the Commission. This strategic plan addresses key District issues associated with complying with the new license requirements for the Priest Rapids Project, resource management issues, operations and maintenance, capital improvements, power supply, customer service, reliability and institutional matters such as community relationships, employee development and succession planning, and legislative and external affairs. The District's financial strategy includes rate stabilization and continued assurance of meeting the District's financial obligations and goals. Financial parameters for the Electric System include 2.0 times debt service coverage, a retail operating ratio of less than or equal to 100%, working capital minimum of \$35 million (excluding special funds), increasing the Electric

System Reserve and Contingency Fund balance to \$120 million, and on average funding a minimum of 50% of capital expenditures from revenue. Financial parameters for the Priest Rapids Project include that outstanding debt shall be less than the net book value of the Priest Rapids Project, 100% debt financing of capital projects, and a debt service coverage no less than 1.15 times, which is the debt service coverage required by the Bond Resolution.

Investments

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

The following summarizes the par value of the District’s investments as of March 31, 2012.

District’s Investments

U.S. Treasuries	\$ 171,500,000
Federal Farm Credit Bank	35,000,000
Federal Home Loan Bank	45,000,000
Fed. Nat. Mortgage Assoc.	38,500,000
Federal Home Loan Discount Note	10,000,000
FNMA Discount Note	15,500,000
Freddie Mac	26,500,000
Freddie Mac Discount Note	12,000,000
Money Market Account	22,333,867
Municipal Bonds	6,675,000
Repurchase	66,700,000
	<hr/>
	\$ 449,708,867

For information relating to the District’s investments, see Note 2 to the Audited Financial Statements for the Years Ended December 31, 2011 and 2010, 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.

Security Efforts at the District

Security has always been an important part of District operations. Following the September 11, 2001 terrorist attacks, the District implemented additional measures to keep facilities and systems safe. In accordance with North American Electric Reliability Council (“NERC”) requirements, an internal compliance plan was implemented at the District in 2007. This plan heightens the security awareness and protection of critical infrastructure, including critical cyber assets. Today, key personnel throughout the District are responsible for critical infrastructure protection and cyber security. Compliance with NERC Standards is closely monitored and tightly managed to meet the District’s vision of “Perfect compliance, all day, every day.” The District continues to demonstrate its commitment to reliability and compliance in this area. In 2011, the District became the first utility in the nation to pass a NERC audit with no findings.

THE PRIEST RAPIDS PROJECT

Description

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

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

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 1,054 MW. Located on the Columbia River in Grant and Kittitas Counties about 160 air miles northeast of Portland, Oregon, 129 air miles southeast of Seattle, Washington, and 18 miles upstream of the Priest Rapids Development, the Wanapum Development includes certain switching, transmission and other facilities necessary to deliver the electric output to the transmission networks of the District, Bonneville and certain other power purchasers.

Energy Production

The following table shows the energy production for the Priest Rapids Project for the years 2007 to 2011. 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

	2007	2008	2009	2010	2011
Priest Rapids Project					
Net Peaking Production (MW)	1,790	1,799	1,782	1,767	1,779
Net Energy Production (000's MWh)	9,145	8,297	7,569	7,061(1)	9,574
Annual Availability Factor (2)	92%	93%	90%	90%	90%
Plant Factor (3)	66%	60%	56%	53%	69%
Average Cost (\$/MWh)	\$11.08	\$14.44	\$14.58	\$18.97	\$14.64
Bonneville Power PF Rate (\$/MWh) (4)	\$27.00	\$27.10	\$26.60	\$28.50	\$28.50

- (1) Run-off was 80% of average in 2010 and 126% of average in 2011.
- (2) 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.
- (3) The average energy output of a generating facility to the net peaking capability of that facility. It reflects the facility's availability, the actual need for the power production by the facility and the availability of water. Plant factor is calculated by dividing gross generation by the maximum one-hour production divided by 8,760 (the hours in one year).
- (4) Bonneville's published Priority Firm power rates.

Based on weather conditions and run-off to date, it is expected that run-off in 2012 will be approximately 113% of average.

Power Sales Contracts

Pursuant to the 1956 Power Sales Contracts, which expired on October 31, 2005, the District sold 63.5% of the power and energy output of the Priest Rapids Development to the Power Purchasers and reserved the remaining 36.5% of the output for its use. The District sold 63.5% of the power and energy output of the Wanapum Development to the Power Purchasers pursuant to the 1959 Power Sales Contracts and reserved the remaining 36.5% of the output for its use. The 1959 Power Sales Contracts expired by their terms on October 31, 2009. The District's new contracts with the original Power Purchasers and ten purchasers in Idaho for the purchase and sale of output from the Priest Rapids Development became effective on November 1, 2005 (the "New Power Sales Contracts"). The New Power Sales Contracts (which also apply to output from the Wanapum Development beginning November 1, 2009) consist of two separate contracts with terms that extend until the expiration of the new long-term license for the Priest Rapids Project (April 1, 2052).

The New Power Sales Contracts consist of the "Product Sales Contract" and the "Reasonable Portion Contract." The New 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. 62% of the output of the Priest Rapids Project is used by the District's Electric System and sold to the Power Purchasers to the extent surplus to the Electric System's needs. The remaining 8% is allocated among various power purchasers. See "Regulatory Proceedings Affecting the Developments—Proceedings Before FERC."

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

**Table 2
PARTICIPATION IN COSTS OF PRIEST RAPIDS PROJECT—2011**

<u>Power Purchaser</u>	<u>Percent Share</u>	<u>Priest Rapids Project Nameplate Rating (1) (MW)</u>
PacifiCorp Electric Operations	9.41%	189.127
Portland General Electric	9.41	189.127
Puget Sound Energy, Inc.	5.42	108.978
Avista Corporation	4.13	82.952
Tacoma Power	2.13	42.884
Seattle City Light	2.11	42.493
Public Utility District No. 1 of Cowlitz County	1.62	32.495
Eugene Water and Electric Board	1.06	21.247
Other Power Purchasers (2)	2.52	50.554
The District's Electric System	62.19	1,249.743
Total	100.00%	2,009.600

- (1) Based on installed nameplate rating of 2,009.600 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 New 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 New Power Sales Contracts include the following provisions:

- Under the Reasonable Portion Contract, the Power Purchasers receive the net 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 the first net revenues from 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 regardless of the revenues produced from the Reasonable Portion Contract. The District pays its share of the costs of the Priest Rapids Project. 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 62% of the Priest Rapids Project output based upon the District's firm retail load. To the extent the District does not take the full 62%, the difference between the District's share and 62% is allocated to the Power Purchasers (for 2012 the Power Purchasers are allocated 2% of the 62%). 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 New Power Sales Contracts in exchange for a fixed percentage of output from the Priest Rapids Project for the term of the New Power Sales Contracts. This makes up the 8% of the output of the Priest Rapids Project remaining after the 30% Reasonable Portion and the 62% allocated to the District under the Product Sales Contract.

The New 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 New Power Sales Contracts, multiplied by the percentage of output or revenue, as applicable, the purchaser is entitled to that year. The New 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 not operating, 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.

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 District has seen active participation in the auction of the Reasonable Portion. Auctions covering the period of November 1, 2005 to October 31, 2009 were for slices of the Priest Rapids Development. Auctions covering the period of November 1, 2009 forward are for slices of the Priest Rapids Project, which includes both the Priest Rapids and Wanapum Developments. The following table summarizes the auction winners to date.

Table 3
REASONABLE PORTION AUCTION WINNERS

Period Covered	Auction Winner	Slice of Priest Rapids Development	Auction Price Priest Rapids Development	Slice of Priest Rapids Project (1)	Auction Price Priest Rapids Project	Total Reasonable Portion Revenues Generated (2)
14 mos. ending Dec. 2006	Constellation Energy	6.52%	\$21,051,369	–	–	\$96,862,127
12 mos. ending Dec. 2007	Powerex	8.86	23,333,666	–	–	79,007,898
12 mos. ending Dec. 2008	Highland Energy	12.33	38,854,741	–	–	94,537,083
10 mos. ending Oct. 2009	Macquarie Cook	11.32	28,639,308	–	–	–
10 mos. ending Oct. 2009	Cargill	11.32	26,860,987	–	–	61,052,286
2 mos. ending Dec. 2009	Macquarie Cook	–	–	10.51%	\$ 5,727,862	–
2 mos. ending Dec. 2009	Cargill	–	–	10.51	5,372,197	29,295,284
12 mos. ending Dec. 2010	PacifiCorp	–	–	6.00	20,332,744	–
12 mos. ending Dec. 2010	Powerex	–	–	12.43	43,684,755	104,206,455
12 mos. ending Dec. 2011	Powerex	–	–	10.14	26,587,218	–
12 mos. ending Dec. 2011	Shell	–	–	10.14	27,953,652	80,721,564
12 mos. ending Dec. 2012	PPL Energy Plus, LLC	–	–	10.14	25,900,819	–
12 mos. ending Dec. 2012	Powerex	–	–	10.14	24,049,915	73,928,072

(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 the firm generation from the Priest Rapids Project in any given year, which are referred to as the District’s Estimated Unmet Load (“EUDL”). The Electric System can then use these revenues to purchase power in the open market. The District’s Electric System is then responsible to pay the costs associated with the power production to the Priest Rapids Project in proportion to the Reasonable Portion revenues taken. Total Reasonable Portion revenues used by the Electric System to meet EUDL requirements were \$11,645,038 for 2006, \$33,071,852 for 2007, \$52,341,435 for 2008, and \$32,089,771 for 2009. In 2010, 2011 and 2012, the Electric System did not use Reasonable Portion Revenues because it does not have EUDL due to the higher percentage of firm Wanapum Development generation that became available to the District on November 1, 2009 under the New Power Sales Contracts.

Priest Rapids Project Output

The actual amounts of energy sold to the Power Purchasers for the fiscal years 2007 through 2011 are shown in the following table. During the years 2007 through 2011, the Priest Rapids Project delivered to the Power Purchasers and the District an average of 8,329,207 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)

	2007	2008	2009	2010	2011
Gross Generation (1)	10,342,293	9,394,961	8,710,613	8,193,903	10,693,863
Plus: Pond Transfer (2)	7,220	76,764	(39,792)	41,451	101,146
Total Dissolved Gas Spill Return (3)	-	-	-	-	8,803
Less: Rock Island Encroachment (4)	(612,604)	(608,844)	(601,733)	(571,821)	(636,667)
Coordination Exchange (5)	(482)	(925)	1,866	695	(6,423)
Less: Canadian Entitlements (6)	(485,174)	(479,080)	(494,308)	(514,055)	(519,351)
Spill Past Unloaded Units (7)	(106,333)	(85,699)	(7,178)	(89,599)	(67,476)
Net Energy to Purchasers	9,144,920	8,297,177	7,569,468	7,060,574	9,573,895
Max. One-Hour Production (MW)	1,790	1,799	1,782	1,767	1,779
Plant Factor (8)	66%	60%	56%	53%	69%
Annual Availability Factor (9)	92%	93%	90%	90%	90%
Disposition of Net Energy (10)					
District’s Electric System	4,447,749	4,000,144	3,651,136	4,036,382	5,715,363
PacifiCorp Electric Operations	1,273,885	1,135,283	732,664	629,567	170,171
Portland General Electric Co.	1,179,528	1,040,256	944,017	687,590	899,578
Puget Sound Energy, Inc.	653,710	664,964	374,752	78,153	55,137
City of Seattle	25,396	23,195	32,988	168,255	32,285
City of Tacoma	191,505	24,970	34,557	37,944	33,983
Avista Corporation	489,601	464,631	420,026	288,389	361,969
Cowlitz County PUD	195,201	175,134	156,109	129,527	151,008
Eugene Water & Electric Board	111,789	97,456	82,600	18,148	15,761
Other Power Purchasers (11)	576,556	671,144	1,140,619	986,619	2,138,640
Total	9,144,920	8,297,177	7,569,468	7,060,574	9,573,895

- (1) Excludes station service energy requirements. Variations from year to year are a result of changing fish spill requirements and Columbia River flows.
- (2) Purchases of generating capability from neighboring hydroelectric projects.
- (3) Energy received as offset for off-system total dissolved gas spill management coordination.
- (4) Energy produced at the Wanapum Development credited to the Rock Island project of Chelan County PUD equivalent to a portion of the energy that would have been produced at the Rock Island project if the Wanapum Development’s reservoir had not encroached on the Rock Island project’s tailrace.
- (5) Priest Rapids Project energy exchanged by the District with parties to the Mid-Columbia Hourly Coordination Agreement.
- (6) Computed power benefits produced at the Priest Rapids Development as a result of upstream Canadian storage.
- (7) Spill among the Mid-Columbia Projects is reallocated based on the requests of the participants through an hourly coordination calculation.
- (8) Gross generation divided by the maximum one-hour production divided by 8,760 (the hours in one year).
- (9) 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.
- (10) The Disposition of Net Energy between power purchasers changed in 2009 due to the New Power Sales Contracts that took effect November 1, 2009 for the Wanapum Development.
- (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.

Coordination Agreements

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

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

Transmission of Power from Priest Rapids Project

The Priest Rapids Project’s 230-kV transmission lines interconnect transmission systems of the District, Bonneville and certain Power Purchasers. These transmission lines currently have sufficient capacity to integrate fully the Priest Rapids Project’s output into the Pacific Northwest’s high-voltage transmission system. A portion of the Priest Rapids Project’s power is delivered directly to the District and certain Power Purchasers via lines owned by the respective parties, with the remainder delivered to the District and the Power Purchasers through the Bonneville transmission system.

The District relies on Bonneville for transmission service of Priest Rapids Project power and transmission of purchased power. Currently, the District has entered into two standard point-to-point (“PTP”) transmission contracts for the purpose of transmitting Priest Rapids Project power. These include a two-year 250 MW PTP contract expiring in 2013 and a five-year 150 MW PTP contract expiring in 2015. The five-year contract contains long-term rollover rights that the District may elect to exercise.

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

The Pacific Northwest-Pacific Southwest Intertie (the “Intertie”) provides the primary bulk transmission link between the Pacific Northwest and the Pacific Southwest. Bonneville owns approximately 73% of the portions of the Intertie located north of California and Nevada. The Intertie consists of four high-voltage transmission lines and associated facilities, and has a combined capacity of about 7,900 MW. Due to operational limitations, Bonneville operates the Intertie at varying levels during the year. The actual transfer capability varies by season and by the amount of generation available on the lower Columbia River. Depending upon the season, the Intertie is rated between 5,200 MW and 6,900 MW.

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 and offers additional transmission-related services, including a multi-party transmission reservation system. ColumbiaGrid is not a regional transmission organization and provides services on a bilateral, contractual basis.

FERC License

Summary

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 pending the disposition of its new license application, filed in 2003. This license application contained a thorough review of Priest Rapids Project resource needs and impacts, as well as a proposed package of resource mitigation measures based on scientific research. On April 17, 2008, FERC issued a new 44-year license for the Priest Rapids Project, 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 NOAA Fisheries and U.S. Fish and Wildlife Service, and the Salmon and Steelhead and Hanford Reach settlement agreements described below.

Fish, Wildlife and Water Quality

The Priest Rapids Project license requires mitigation and enhancement measures including: operation of the Wanapum fish bypass and spill to improve downstream passage of juvenile salmon and steelhead; development and construction of a top-spill bypass for the Priest Rapids Dam; continued operation and improvements to upstream fish passage facilities; sluiceway spills for fallback and kelt passage; operations and monitoring to improve conditions for fall Chinook salmon in the Hanford Reach; implementation of plans to improve anadromous fish habitat; implementation of a performance evaluation program, including various anadromous fish monitoring and evaluation studies; implementation of hatchery programs for five species of salmon and steelhead; implementation of management plans for bull trout, Pacific lamprey, white sturgeon, and native resident fish; implementation of a total dissolved gas abatement program; monitoring of water temperature, dissolved oxygen, and pH; and implementation of numerous plans to protect and enhance wildlife and associated habitat. The capital cost of these measures from 2012 to 2014 is estimated at \$58 million.

Section 401 Water Quality Certification

As part of the relicensing process for the Priest Rapids Project, the District applied to Ecology for water quality certification. Under Section 401(a)(1) of the Clean Water Act (“CWA”), FERC may not issue a license authorizing the construction or operation of a hydroelectric project unless the state water quality certifying agency either has issued water quality certification for the project or has waived certification by failing to act on a request for certification within a reasonable period of time, not to exceed one year. Section 401(d) of the CWA provides that the certification shall become a condition of any federal license that authorizes construction or operation of the Project.

On April 3, 2007, Ecology issued a certification for the Priest Rapids Project. On March 17, 2008, Ecology filed a revised certification, which contains the conditions that are incorporated into the FERC license. The certification requires that the Priest Rapids Project be operated pursuant to: (1) the Salmon Agreement for spring, summer, and fall Chinook salmon; steelhead; sockeye salmon; and coho salmon; and (2) the bull trout, white sturgeon, Pacific lamprey, and native resident fish management plans as provided in the quality certification. The certification requires the establishment of groups for coordination and implementation of the requirements under the Salmon Agreement, as well as implementation of measures to determine attainment of specified biological objectives. These measures include the requirement to provide funds (not to exceed \$1,500,000) to renovate the existing Columbia Basin Hatchery facility to ensure stable operations at current capacity for the term of the license.

Recreation Resources

The Priest Rapids Project is an important regional recreation resource. The District supports the development of public recreation facilities when implemented in the broader public interest that do not interfere with operations of the Priest Rapids Project or conservation objectives. The District developed a Recreation Resource Management Plan as part of the relicensing application. The plan identified measures for recreation sites located within or adjacent to the existing Priest Rapids Project boundary. At the Wanapum Development, there are 23 developed and

undeveloped recreation sites, including boat launches, campgrounds, picnic areas, and the Wanapum Dam Heritage Center, located at the dam. At the Priest Rapids Development, there are 12 developed and undeveloped recreation sites, including boat launches, campgrounds, and picnic areas. Of these 35 total recreation sites, 23 recreation sites are project-related and located within the boundary of the Priest Rapids Project, including the Crab Creek Corridor. A total of \$36 million is budgeted for recreation improvements during 2012-2014 as required by the new license. In addition, the new license requires the District to file a shoreline management plan with FERC to protect the scenic quality of the mid-Columbia River. A component of the shoreline management plan is to file a plan for the future use of Crescent Bar Island after 2012. This plan will include additional public recreation and wildlife habitat enhancement measures on Crescent Bar Island. This plan will be finalized and submitted to FERC in 2012 or 2013 (subject to the outcome of pending litigation with current leaseholders). See "LITIGATION."

Cultural Resources

During relicensing of the Priest Rapids Project, the District initiated cultural resource identification surveys. These surveys 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 1,248. The Programmatic Agreement for Cultural Resources ("PA") was executed on April 12, 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. The new license also calls for the development of a Historic Properties Management Plan ("HPMP") that provides guidelines for long-term management of the District's cultural resources. The HPMP governs how cultural resources are addressed during the duration of the District's FERC license. Over \$9 million is budgeted for the 2012-2014 time period for cultural resource management.

Wanapum Agreement

The new license requires 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 will be a facility dedicated to the protection, preservation, interpretation and perpetuation of the Wanapum culture and the cultural resources of the Columbia River from the confluence of the Snake River northwards to the Rock Island area. The existing Wanapum Heritage Center is composed of the Cultural Resources Program, a Museum, the Repository, and the Living Culture Program. Currently, these facilities are dispersed within the Priest Rapids Project area with some components housed within the dam, in various houses and in the existing Museum which is near the secure area where future access will be restricted. Under this program, the District is planning for development of a new, comprehensive facility for the program near Priest Rapids Dam and adjacent to the Columbia River. This site is owned by the District, near the current Wanapum Indian Village, and has cultural significance to the Wanapum Indians. Interior space includes a new permanent exhibit, expanded repository, library, oral history work room, and other functional space as needed. The total estimated cost of this project from 2012 through 2014 is \$17 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 new license term. The benefit to the Yakama Nation is the financial equivalent of 20 aMW for 2007-2009, 15 aMW for 2010-2015 and 10 aMW throughout the term of the agreement. After 2015, the Yakama Nation can request to have actual physical power delivered. The Yakama Nation is responsible to pay the Priest Rapids Project costs associated with producing the benefit received (either financial or physical delivery).

Considerations to be provided by the Yakama Nation to the District throughout the life of the agreement 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 new license requirements.

The agreement went into effect on July 1, 2007. The net payments to the Yakama Nation totaled \$825,668 for 2011 and \$2.4 million for 2010. These costs were charged to Priest Rapids Project license compliance and related agreements expense. 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 annual costs for this agreement are estimated at between approximately \$1.5 million and \$2.0 million.

Regulatory Proceedings Affecting the Developments

Proceedings Before FERC

Advanced Turbine Replacement. As discussed under “Rehabilitation Program—Priest Rapids Project,” FERC’s 2004 order authorizing the installation of advanced turbines at the Wanapum Dam allows staged installation of new, more efficient turbines. The District is replacing all ten of the existing turbines at Wanapum Dam. The new turbines have increased power output and efficiency, and include features intended to improve the survival of fish. The order from FERC also incorporates conditions in the 2007 Water Quality Certification issued by Ecology requiring, among other conditions, a study of the Total Dissolved Gas (“TDG”) production of the new turbines and mitigation for any increases associated with increased TDG production from the new turbines as compared to the existing turbines. The TDG Study that was conducted following the first new turbine installation concluded the new turbine did not increase TDG production and, therefore, no mitigation was required. Turbine Units 8, 4, 10, 9, 3, 6, 7 and 5 have been successfully replaced. The advanced turbine is an important measure projected to improve conditions for fish and water quality within the Wanapum Development’s project area, and the District expects to complete the remaining units over the next two years. The estimated cost of this program from 2012-2014 is \$24.5 million.

Proceedings Related to Allocation of Output. Public Law 83-544 (“PL 83 544”) is federal legislation enacted in 1954 that enabled the District to construct the Priest Rapids and Wanapum Developments. 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. On February 11, 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. The D.C. Circuit Court of Appeals affirmed FERC’s rulings in all respects. No further appeals were filed and the litigation is now concluded. See “Power Sales Contracts.”

Endangered Species and Other Fish Issues

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.

National Oceanic and Atmospheric Administration (“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. If jeopardy or adverse modification is found, NOAA Fisheries can suggest reasonable and prudent alternatives so as to avoid jeopardy. If jeopardy is not avoided

through the implementation of reasonable and prudent alternatives, no incidental take statement can be issued. In such event, project operations would continue to be subject to being enjoined or altered, and the District would remain exposed to fines and penalties for ESA violations.

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

Federal Project ESA Litigation. With several salmon species listed under the ESA, Bonneville, the U.S. Bureau of Reclamation, and the U.S. Army Corps of Engineers have undertaken and are implementing certain measures to protect salmon. Many of these measures have been mandated by NOAA Fisheries pursuant to the ESA in the Biological Opinions produced under the ESA. These regulatory requirements are required by the ESA in order for these federal agencies to avoid actions that would jeopardize the listed species. There has been extensive and on-going litigation of the Biological Opinions produced for federal hydroelectric projects. Most of this litigation centers on legal issues associated with ESA interpretations and required fish passage measures and river flow requirements. 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, 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 and is based on the experience learned from 1999-2003 and is supported by an extensive body of research, modeling and evaluation. Additional signatories to the Hanford Reach Agreement are the U.S. Fish and Wildlife Service and the Yakama Nation.

Salmon and Steelhead Agreement. In 2006, the District entered into an agreement (the "Salmon and Steelhead Agreement") with the U.S. Department of Interior, U.S. Fish and Wildlife Service, NOAA Fisheries, the Washington Department of Fish and Wildlife, the Yakama Nation, and the Confederated Tribes of the Colville Reservation, for the purpose of resolving all issues between the District and the other signatories related to anadromous salmonid fish species in connection with the District's new license for the Priest Rapids Project. 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.

In order to implement the Salmon and Steelhead Agreement, the District is obligated to establish separate restricted funds (the "Habitat funds") into which the District will deposit payments for further distribution in accordance with the requirements of the Salmon and Steelhead Agreement and the Biological Opinion. The Priest Rapids Coordinating Committee ("PRCC") oversees the distribution of the Habitat funds created through the Salmon and Steelhead Agreement. The voting members of the PRCC include the District, the U.S. Fish and Wildlife Service, NOAA Fisheries, Washington Department of Fish and Wildlife, the Confederated Tribes of the Colville Reservation, and the Yakama Nation. The Habitat funds cannot be spent without the unanimous consent of all voting members. All interest earned by the Habitat funds increase the balance of these funds and is not recognized as income by the District. Expenditures of these funds must be made in accordance with the Salmon and Steelhead Agreement and the Biological Opinion for the protection and restoration of habitats along the mainstem and tributaries within the Upper Columbia River watershed including the Okanogan, Methow, Entiat, and Wenatchee River watersheds. These funds 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 new 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, 2011 and December 31, 2010 equaled \$5.6 million and \$3.1 million, respectively. The District expects to contribute approximately \$18.3 million during the period 2012 through 2016.

Draw-Down and Dam Removal Proposals. Removal or drawdown of dams is a controversial issue that has been subject to much discussion in the Pacific Northwest and the nation. Neither is a significant issue in the case of the mid-Columbia River. However, the removal of any of the 11 federal hydroelectric projects on the Columbia River and/or permanent draw-downs could have a significant effect on any or all of the following: local and/or regional economies, power supplies, navigation, flood control, wildlife habitat and irrigation, dam owners and operators and power purchasers. The District believes that it is 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. Removal or permanent draw down of either Development would preclude any power generation and would have a material adverse effect on the financial condition of the District and the security for the Parity Bonds.

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. During the relicensing process, the District obtained a Biological Opinion and Incidental Take Statement covering Priest Rapids Project operations under the 44-year license issued in 2008. This 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. To the extent the unit cost of power from the Priest Rapids Project increases to the point where it is not competitive with other firm power resources in the region, it could have a material adverse effect on the security for the Parity Bonds, including the Bonds.

Rehabilitation Program – Priest Rapids Project

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

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

All ten of the Wanapum Development generators were rewound between 1983 and 1994. During the rehabilitations, problems were discovered with cracking of the turbine trunnion keyways. Initial repairs on the first eight units were not successful as the cracking reoccurred after several years of operation; however the last two units were successfully repaired using a different method. In addition to the cracking of the turbine trunnion keyways, cracking of the turbine blades themselves was discovered to be occurring. The cracks were found on both the pressure and suction sides of the blades and extended into the blade root area in all cases. In 1996 the District began working on designs for replacing the turbines at the Wanapum Development. In 2004 the District received approval from FERC for a license amendment to install, test and operate a new advanced turbine in Wanapum Unit 8. Unit 8 was placed in service with the new turbine in 2005. Testing of turbine performance was completed with satisfactory results and FERC authorized the District to install the remaining nine new turbines. To date, new turbines have been successfully installed for eight of the ten Wanapum units with the most recent being placed in service in February 2012.

The District is currently installing the ninth advanced turbine, which is expected to begin generating in December 2012. The District anticipates completing the remaining unit in October 2013. As of December 31, 2011, the cost of the remaining turbines to be replaced is estimated at \$24.5 million.

To get full use of the new turbines, the District is also replacing and upgrading the generators at the Wanapum Development. In 2009 a contract was awarded to Alstom Hydro US, Inc. for \$150 million to upgrade all ten generators at Wanapum Development. The second generator was placed in service in February 2012. The on-site construction is scheduled through January 2018. The existing generators are currently rated at 109.25 megavolt-amperes (“MVA”). The new generators will have a nameplate rating of 128.6 MVA, an increase of 17.7%. As of December 31, 2011, the cost of replacing the remaining eight generators is estimated at \$128.6 million.

In addition to the Wanapum turbine and generator replacement project, the District is initiating design and engineering work on turbine life extension/replacement and generator rewinds for the Priest Rapids Development. Initial modeling has begun and the District expects to be working through the design and contracting process in 2012 and 2013, with turbine upgrade installation at the Priest Rapids Development beginning in 2015 and completed by 2024.

Main generating unit circuit breakers have been replaced at the Wanapum and Priest Rapids Developments. From 2005-2009 the five main step-up transformers were replaced at the Priest Rapids Development. The main step-up transformers are also being replaced at the Wanapum Development beginning in 2012. The hydraulic governors at both plants have been approved for upgrades to digital hydraulic models. This work will follow the generator upgrade projects at both plants and will also include upgraded generator protection and unit control systems. Over the next five years the plant 600 V and 13.2 KV switchgear is scheduled for replacement at both developments. All major plant cranes have been rebuilt, and spillway gates are being 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 Wanapum was completed in the spring of 2011. Following the trunnion work, the Wanapum spillway gates are scheduled for a new paint system. Replacing the paint system 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 system contains lead. The Wanapum spillway gate painting will begin in 2012 and is expected to be completed in 2019. In addition to the painting, the District is continuing to make modifications to the spillway gates to address the recently updated seismic and structural requirements.

Estimated Capital and Financing Requirements

The District projects that the total cost of the capital program at the Priest Rapids Project during the period 2012 through 2014 will be approximately \$359 million, as shown in Table 5, which will be financed by the 2012M Bonds and prior and future bond proceeds of the Priest Rapids Project.

Table 5
PRIEST RAPIDS HYDROELECTRIC PROJECT
2012-2014 FORECAST CAPITAL PROGRAM EXPENDITURES

Turbine/Generator Restoration	\$ 121,202,000
License Implementation	142,846,000
Powerhouse Improvements	50,477,000
Miscellaneous (1)	44,920,000
	<hr/> \$ 359,445,000

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

Future Borrowings

The District may issue additional Parity Bonds in the next two years in the approximate amount of \$187 million to finance a portion of additional improvements to the Priest Rapids Project.

Operating Results

Table 6 shows actual operating results for the Priest Rapids Project for the fiscal years 2007 through 2011. 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 New 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 POWER CONTRACTS."

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

	2007	2008	2009	2010	2011
Operating Revenues					
Sales of Power (1)	\$ 101,350	\$ 119,874	\$ 110,376	\$ 133,945	\$ 140,183
Interest and Other Income (2)	<u>12,003</u>	<u>6,393</u>	<u>3,484</u>	<u>5,955</u>	<u>7,864</u>
Total Revenues and Other Income	\$ 113,353	\$ 126,207	\$ 113,860	\$ 139,900	\$ 148,047
Operating Expenses					
Generation	\$ 28,340	\$ 37,923	\$ 26,799	\$ 21,966	\$ 22,277
Transmission	2,025	1,980	2,060	1,985	2,232
Administrative and General License Compliance and Related Agreements (3)	25,183	30,065	16,308	15,435	14,895
Taxes	0	0	18,362	25,260	25,050
Total Operating Expenses	<u>1,964</u>	<u>1,779</u>	<u>1,735</u>	<u>1,398</u>	<u>2,065</u>
Net Revenues	\$ <u>55,841</u>	\$ <u>54,460</u>	\$ <u>48,596</u>	\$ <u>73,856</u>	\$ <u>81,528</u>
Transfer Requirements (4)	48	0	6,000	0	0
Unused bond proceeds refunded	0	0	0	16	0
Excess Available in Supplemental R&R Fund	\$ <u>6,128</u>	\$ <u>8,189</u>	\$ <u>8,183</u>	\$ <u>8,196</u>	\$ <u>10,228</u>
Remaining Net Revenues Available for Debt Service on Parity Bonds	\$ <u>62,017</u>	\$ <u>62,649</u>	\$ <u>62,779</u>	\$ <u>82,068</u>	\$ <u>91,756</u>
Debt Service on Parity Bonds	\$ 53,953	\$ 54,551	\$ 54,642	\$ 71,842	\$ 79,787
Debt Service Coverage on Parity Bonds (5)	1.15x	1.15x	1.15x	1.15x	1.15x
Net Energy Output (MWh) (6)	9,144,920	8,297,177	7,569,468	7,060,574	9,573,895
Average Cost (\$/MWh) (7)	\$11.08	\$14.45	\$14.58	\$18.97	\$14.64

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

(2) Interest on various funds of the Priest Rapids Project.

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

(4) Represents amounts transferred to the 1956 Renewal and Replacement Fund, 1963 Reserve and Contingency Fund and the 1963 Bond Reserve Account or to be credited to power costs. In 2007, the money was used for payment of extraordinary items out of the construction funds. In 2009, the balances represent the refunding of the 1963 Reserve and Contingency Fund to the power purchasers as set forth in the original power sales contract that expired on October 31, 2009.

(5) Annual charges for sales of power are set at levels sufficient to produce revenues providing debt service coverage of 1.15x.

(6) Run-off was 99% of average in 2007, 92% of average in 2008, 82% of average in 2009, 80% of average in 2010 and 126% of average in 2011.

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

Certain columns may not add due to rounding.

Monthly payment by the Power Purchasers and the Electric System of their respective shares of Annual Power Costs is required by the New 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 \$22 per MWh under average water conditions.

Debt Service Requirements for the Priest Rapids Project

The following table gives debt service requirements for the Outstanding Parity Bonds and for the Bonds.

Table 7
PRIEST RAPIDS PROJECT TOTAL DEBT SERVICE REQUIREMENTS (1)

Year (2)	Outstanding Parity Bonds(3)(4)			The Bonds(4)			Aggregate Debt Service on Parity Bonds
	Priest Rapids	Wanapum	Priest Rapids Project	Principal	Interest	Total	
2012(5)	\$ 20,861,965	\$ 28,470,878	\$24,151,514	--	--	--	\$ 73,484,356
2013	19,891,537	24,354,570	24,128,739	\$1,400,000	\$ 5,864,559	\$ 7,264,559	82,903,965
2014	18,858,538	22,430,297	24,117,486	4,175,000	5,492,820	9,667,820	84,741,960
2015	17,193,022	20,796,465	24,117,196	4,365,000	5,299,424	9,664,424	81,435,531
2016	17,190,413	20,785,018	24,117,721	4,570,000	5,094,548	9,664,548	81,422,248
2017	17,171,429	20,752,538	24,101,671	4,785,000	4,878,225	9,663,225	81,352,088
2018	16,140,289	19,881,738	24,077,322	5,115,000	4,647,000	9,762,000	79,623,349
2019	14,747,322	17,814,015	22,238,724	6,760,000	4,365,170	11,125,170	77,050,400
2020	14,727,544	17,799,644	22,186,592	7,090,000	4,032,779	11,122,779	76,959,338
2021	14,725,029	17,801,419	22,123,947	7,420,000	3,683,105	11,103,105	76,856,604
2022	12,893,000	15,862,529	22,052,700	5,690,000	3,367,798	9,057,798	68,923,824
2023	12,884,134	15,860,054	21,984,176	5,980,000	3,088,015	9,068,015	68,864,393
2024	10,442,915	15,846,846	19,670,496	2,930,000	2,876,239	5,806,239	57,572,736
2025	10,421,906	15,842,369	19,598,410	3,065,000	2,736,147	5,801,147	57,464,979
2026	10,411,788	15,836,097	19,522,114	3,210,000	2,588,431	5,798,431	57,366,861
2027	10,417,278	15,819,797	106,903,287(6)	3,360,000	2,432,821	5,792,821	144,726,004
2028	10,405,754	15,817,676	19,370,674	3,530,000	2,267,680	5,797,680	57,189,463
2029	10,385,588	15,806,801	19,187,933	3,695,000	2,092,927	5,787,927	56,956,177
2030	10,379,879	18,352,347	19,001,699	1,270,000	1,976,780	3,246,780	54,227,485
2031	9,886,727	17,940,360	18,800,356	1,320,000	1,922,196	3,242,196	53,111,836
2032	6,338,410	16,592,693	18,592,530	43,775,000(7)	1,035,589	44,810,589	131,144,810
2033	6,334,397	16,579,744	18,377,302	1,315,000	148,555	1,463,555	44,218,554
2034	3,977,861	16,565,051	18,163,216	1,370,000	90,891	1,460,891	41,627,909
2035	3,966,509	16,551,315	17,924,252	1,430,000	30,738	1,460,738	41,363,552
2036	3,965,527	16,532,117	17,684,388	--	--	--	38,182,032
2037	--	16,516,810	17,437,022	--	--	--	33,953,832
2038	--	16,501,644	17,175,842	--	--	--	33,677,486
2039	--	9,668,927	16,909,390	--	--	--	26,578,317
2040	--	9,656,998	16,631,064	--	--	--	26,288,062
2041	--	9,648,363	--	--	--	--	9,648,363
2042	--	9,636,833	--	--	--	--	9,636,833
2043	--	9,621,356	--	--	--	--	9,621,356
Total	\$ 304,618,759	\$ 537,943,303	\$680,347,763	\$127,620,000	\$ 70,012,437	\$ 197,632,437	\$1,918,174,700

(1) Columns may not add due to rounding.

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

(3) Excludes the Refunded Bonds.

(4) Before the federal credit payments.

(5) Includes the January 1, 2012 payment already made.

(6) A portion of this represents the \$90,000,000 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.

(7) The 2012M Bonds are New Clean Renewable Energy Bonds 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 the \$42,395,000 of such 2012M Bonds maturing on January 1, 2032. See "DESCRIPTION OF THE BONDS—Sinking Fund Payments-2012M Bonds."

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 2011, the Electric System operated approximately 4,232 miles of lines and served approximately 46,351 retail customers. As of December 31, 2011, the District's gross investment in the Electric System was \$840 million and its net investment was \$474.9 million. The Electric System has established as a goal the funding of (on average) no more than 50% of capital improvements from bond proceeds, excluding generation projects. The District's Priest Rapids Project is the primary source of power for the Electric System.

Retail Energy Sales and Customers

The Electric System's gross operating revenues for 2011 totaled approximately \$240.1 million. Of this total, approximately \$134.8 million (56%) was derived from retail energy sales to an average of 46,351 customers. Sales to other utilities provided approximately \$100.5 million of revenues (42% of the total). See "Power Supply Management and Power Marketing." Of the retail customers, 76% were residential customers, providing 25.5% of all retail energy revenues. The number of retail customers, energy sales and revenues for the year ended December 31, 2011, for each major retail customer class are listed below.

Table 8
ELECTRIC SYSTEM
2011 RETAIL CUSTOMERS, ENERGY SALES AND REVENUES

Customer Class (1)	Average Number of Customers		Energy Sold		Revenue (2)	
	Number	%	GWh (3)	%	\$000	%
Residential	35,463	76.51	782.6	19.38	34,342	25.48
Commercial	6,080	13.12	467.2	11.57	17,114	12.70
Irrigation	4,573	9.87	509.1	12.61	17,271	12.81
Industrial	116	0.24	2,273.3	56.28	65,071	48.27
Other	119	0.26	6.4	0.16	1,006	0.74
Total	46,351	100.00	4,038.6	100.00	134,804	100.00

(1) Statistics reported by class of service classification.

(2) Includes municipal taxes.

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

The ten largest customers, based on retail revenue of the Electric System for the 12 months ended December 31, 2011, are shown in the following table.

Table 9
ELECTRIC SYSTEM LARGEST CUSTOMERS
(Listed alphabetically)

Customer	Location	Product
Basic American Foods, Inc.	Moses Lake	Dehydrated potatoes and fresh packed potatoes
Chemi-Con Materials Corp.	Moses Lake	Process aluminum foil for capacitors
City of Moses Lake	Moses Lake	Municipality
EKA Chemicals, Inc.	Moses Lake	Crystal sodium chlorate and liquid sodium chlorate
J.R. Simplot	Quincy	Vegetables processor
Lamb-Weston, Inc.	Quincy	French fried potatoes
Microsoft Corp.	Quincy	Data center
Moses Lake Industries, Inc.	Moses Lake	Manufacture highly purified raw chemical components
Norco, Inc.	Moses Lake	Liquid nitrogen, oxygen and argon
REC Solar Grade Silicon LLC	Moses Lake	Polycrystalline silicon and silane gas
Yahoo!	Quincy	Data center

The Electric System's ten largest customers used approximately 46% of total retail energy sold and provided approximately 40% of retail revenues in 2011. The two largest customers used approximately 27% of total retail energy sold and provided approximately 24% of retail revenues in 2011. The District's rate structure for industrial customers is designed to include the marginal cost of additional power purchases. The Priest Rapids Project New Power Sales Contracts contain provisions that when coupled with the low production cost of the Project mitigate the impacts to the District from loss of significant quantities of retail load.

The District continues to see large industrial and manufacturing customers locate or enlarge operations in the County. REC Solar Grade Silicon LLC has constructed a large expansion to its facilities and has increased its electrical load substantially since 2009. Carbon manufacturer SGL Group has finished with Phase I of its plant that will make carbon fiber based products for BMW with plans to finish Phases II and III by 2016. Several internet server farms, including Microsoft, Yahoo!, Intuit, Dell and Sabey Data Centers, have been built that have substantial electrical loads and utilize the District's telecommunications infrastructure and low cost electricity. See "Telecommunications" below. An increase in system load of 10% to 15% is expected over the next five to seven years, primarily due to a large increase in industrial and manufacturing loads. 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

	2007	2008	2009	2010	2011
Number of Customers					
(Average) (1)					
Residential	33,457	34,326	34,901	35,215	35,463
Commercial	5,628	5,782	5,899	5,999	6,080
Irrigation	4,446	4,493	4,541	4,553	4,573
Industrial	103	115	117	113	116
Other (1)	120	121	118	118	119
Total Customers	43,754	44,837	45,576	45,998	46,351
Energy Sales (MWh) (1)					
Residential	721,885	750,149	819,448	729,695	782,633
Commercial	424,166	444,447	467,134	439,988	467,188
Irrigation	521,363	555,748	541,930	503,706	509,086
Industrial	1,574,663	1,773,930	1,881,258	2,198,721	2,273,282
Other (2)	5,459	5,648	5,896	6,044	6,419
Total Energy Sales	3,247,536	3,529,922	3,715,666	3,878,154	4,038,608
System Peak (MW)					
Winter	523	589	660	643	655
Summer	572	623	640	662	664
Revenues from Energy					
Sales (\$000) (1)					
Residential	\$ 30,323	\$ 31,926	\$ 33,211	\$ 31,252	\$ 34,342
Commercial	14,568	15,346	15,658	15,507	17,114
Irrigation	15,881	16,556	16,422	16,295	17,271
Industrial	39,458	46,427	48,602	58,865	65,071
Other (2)	905	931	971	981	1,006
Total Revenues	\$ 101,135	\$ 111,186	\$ 114,864	\$ 122,900	\$ 134,804

(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 2007 to 2011 grew 44%.

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

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

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

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

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

The District entered into a contract to sell a portion of the Electric System's share from the Priest Rapids Project to Iberdrola Renewables, Inc. effective December 1, 2011 and terminating November 30, 2014. The purpose of this sale and an associated schedule of firm fixed-price power purchases was to hedge water volume and operational risks through greater portfolio diversification. The associated schedule of firm fixed price power purchases was developed to achieve the stated goal of a reduction in the operational and water volume risk level while creating no additional firm deficit volume or price risk in any monthly period (i.e., no incremental monthly firm "short" exposure resulted from the hedge strategy although the average "long" position was reduced). This 12% share of the

Priest Rapids Project output increases District net revenue stability by improving the predictability of wholesale revenues. The \$104.4 million contract is paid in 36 equal monthly installments over the life of the agreement. The District has the right to curtail delivery in the event of non-payment.

The table below summarizes wholesale power sales, including the portion of the District's share of the Priest Rapids Project's output in excess of the Electric System's needs, and the average price for the calendar years 2007 through 2011.

Table 11
ELECTRIC SYSTEM
WHOLESALE ENERGY SALES (1)

	2007	2008	2009 (2)	2010 (2)	2011(2)
Wholesale Energy Sales (\$000) (1)	\$ 119,195	\$ 115,636	\$ 87,908	\$ 86,385	\$ 100,547
Total MWh (3)	3,317,929	3,360,177	3,111,968	2,777,244	3,282,143
Average Revenue (\$/MWh)	\$ 35.92	\$ 34.41	\$ 28.25	\$ 31.10	\$ 30.63

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

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

(3) Run-off was 80% of average in 2010 and 126% of average in 2011.

To mitigate risks associated with power marketing activities, the District has established risk management guidelines that have been adopted by the Commission. In recognition of the increasing number of power transactions, price volatility and changing power supply contracts, the Commission established a Risk Oversight Committee in 2001 to review and update the energy risk management policies of the District and to provide greater ongoing monitoring and review of power transactions. The Risk Oversight Committee undertook a review by a utility consultant of the District's policies and controls, which was completed in the summer of 2001. Utilizing the recommendations of this report, the Risk Oversight Committee developed Energy Risk Management Policies that were adopted by the Commission. The Energy Risk Management Policy and Procedures outline the parameters for transaction, trader and counterparty exposure. Key elements of the policies include: (1) sales and purchases shall only be made to meet the District's prospective needs, to dispose of surplus power and to maximize use of the Priest Rapids and Wanapum Development reservoirs; no speculative sales or purchases are to be made; (2) power transactions shall not exceed a duration of 18 months; (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 position, sell surplus power or purchase power where the District is in a deficit position; and (6) monitoring reports describing all concluded transactions and expected future transactions (priced to current market prices) as compared to the District's adopted budget for that year are reviewed by District management on a frequent basis. The District believes that these policies limit the risk of any substantial financial loss resulting from the District's power supply management activities.

The District has entered into hedging agreements in the form of International Swaps and Derivatives Association ("ISDA") agreements with two different entities. The agreements are designed to manage price risk associated with power transactions and, in all cases, will be used to hedge the risk of an underlying physical position. The District does not, at this time, anticipate executing any further ISDA agreements.

The ISDA agreements require that the District post collateral in the form of a letter of credit to secure its obligation to pay under the contracts if certain predetermined thresholds are met or the counterparty has commercially reasonable grounds for insecurity regarding the District's performance. Thresholds on the two agreements in place are currently at 3.5 times the District's internally-allowed credit exposures. Credit exposures are monitored continuously and calculated weekly on notional and mark-to-market values. In the event that credit exposure

approaches a predetermined threshold, the District would determine the most appropriate course of action including, but not limited to, trading out of the given transactions. If no other action was deemed to be in the best interest of the District, the District would proceed to provide a letter of credit or collateral within 20 business days depending on the triggering event. The collateral provisions are reciprocal, meaning that the District has the right to ask its counterparties to post collateral if the exposure of the forward transactions moves in the District's favor and the predetermined thresholds are met.

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 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 for the District in 2011 was \$975 and the average cost per kWh for residential service in the District was 4.42 cents.

Table 12
ELECTRIC SYSTEM
MONTHLY ELECTRIC BILLS COMPARISON (1)
As of April 13, 2012
(Winter Rates where applicable)

	Residential (1,500 kWh)	Commercial (30 kW 9,000 kWh)	Industrial (400 kW 150,000 kWh)
The District	\$ 72	\$ 384	\$ 4,450
Washington State Public Utility Districts			
Benton County PUD No. 1	114	565	9,451
Chelan County PUD No. 1	48	260	4,502
Clark Public Utilities	134	718	10,131
Douglas County PUD No. 1	40	196	3,549
Franklin County PUD No. 1	121	641	8,831
Grays Harbor County PUD No. 1	124	701	10,543
Kittitas County PUD No. 1	143	754	9,280
Klickitat County PUD No. 2	125	536	9,347
Lewis County PUD No. 1 (2)	91	478	7,369
Mason County PUD No. 3 (2)	113	648	9,060
Snohomish County PUD No. 1	133	748	11,566
Washington Cities			
City of Ellensburg	103	564	8,278
City of Richland	96	403	7,099
City of Seattle	127	621	9,324
City of Tacoma	112	666	8,118
Private Power Companies			
Avista	123	895	12,466
Pacific Power (a PacifiCorp Company)	125	767	9,830
Portland General Electric	165	799	11,899
Puget Sound Energy (3)	156	832	13,227

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

(2) Rates as of May 1, 2012.

(3) Rates as of May 14, 2012.

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. 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
February 1, 2012	8

The forecast adopted by the Commission has future overall annual rate increases of 8% each year for the years 2013 through 2015, which are subject to final Commission action.

The Electric System's Power Supply

In 2011, the Electric System obtained approximately 69% of its firm energy requirements from the District's share of the Priest Rapids Project and the Bonneville contract, and the remainder from the Quincy Chute Hydroelectric Project, P.E.C. Headworks Powerplant Project, Nine Canyon Wind Project, and market purchases. The cost of Bonneville power to the Electric System was offset directly by the additional wholesale power sales revenues provided by the New Power Sales Contracts. See "THE PRIEST RAPIDS PROJECT—Power Sales Contracts." Since 2005, the New 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 a small amount of power from Bonneville to serve loads in the Grand Coulee area and the District obtains most of its power from the Priest Rapids Project.

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 32,430 MWh in 2011.

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 13,314 MWh in 2011.

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 having an expected aggregate output of about 10,756 annual average megawatts ("aMW") under average water conditions and about 8,478 annual aMW under critical water conditions (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, provides that Bonneville serves only the District's loads in the Grand Coulee area, which is a small area not easily served by the Priest Rapids Project. The District does not have a contract with Bonneville to serve any other District loads.

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

See "THE PRIEST RAPIDS PROJECT—Transmission of Power from Priest Rapids Project" for a discussion of the District's transmission contract with Bonneville.

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.

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

Operation of the Priest Rapids Project is affected by the Treaty. In general, the Treaty and its implementing agreements are implemented via the Pacific Northwest Coordination Agreement, which provides a means to coordinate the operation of all major power plants and transmission systems in the Pacific Northwest for the mutual benefit of the participants and a method to obtain and distribute the increased power benefits resulting from construction of the Canadian water storage facilities. These agreements expire in 2024 if termination notice is supplied by either party 10 years prior to 2024. The agreements may terminate after this date with a 10-year termination notice by either party.

Energy Conservation

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

The District has been actively involved in conservation programs since the Residential Conservation Service Program required by the National Energy Conservation Policy Act of 1978. As a result of the Pacific Northwest Electric Power Planning and Conservation Act (1980), Bonneville began implementing conservation programs for resource acquisition purposes. Utilities, including the District, carried out these programs on a local level. In 1995, Bonneville reduced its conservation programs, but the District, recognizing the value of promoting cost-effective

energy conservation, voluntarily continued to promote and finance programs without Bonneville's financial assistance.

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

Conservation opportunities are being actively pursued by the District to achieve a least-cost power supply. Conservation cost-effectiveness will be measured against the avoided cost of the next new resource available to the District, as defined by the Washington Constitution and State law. The amount spent for programs each year is established through the District's annual budgeting process. Pursuant to requirements in State Initiative 937, the District has set conservation MWh targets for the years 2012 through 2021 and will review and set new ten-year targets every two years. The ten-year target was set at 24,565.7 MWh with a second biennium target of 50,974.1 MWh. These targets will be met by conservation coming from any existing programs and any new conservation programs created during the target period. See "Legislation and Initiatives" below.

Nine Canyon Wind Project

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

Phase I of the project became commercially operable in 2002. Costs of constructing the project were financed through the issuance of \$70,675,000 of revenue bonds by Energy Northwest, which mature on July 1, 2023. Annual costs, including repayment of debt service, is 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, 2011 was \$68.87 per MWh. The projected net cost for calendar year 2012 is expected to be \$60.90 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 2011, the District received approximately 29,963 MWh of wind generation output from the project and the District is projecting output from the project to be about 35,000 MWh in 2012.

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 \$3.365 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 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.

Wapato Hydroelectric Project

The District entered into a long-term purchase power agreement with the Yakama Nation for the output of the Wapato Hydroelectric Project. The Wapato Hydroelectric Project consists of two plants and is located within the boundaries of the Yakama Indian Reservation in Yakima County, Washington, and irrigates about 142,000 acres. The hydroelectric output from the Wapato Hydroelectric Project was approximately 0.8 aMW in 2011 and is expected to be approximately 0.5 aMW in 2012. The output is seasonal and concurrent with the irrigation season that runs from March through October. The rated capacities of the Wapato Hydroelectric Project are 1.6 MW and 2.5 MW, respectively.

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

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, 2011, the District's Wholesale Fiber Optic Network was available to over 21,700 homes and businesses within Grant County. Over 6,420 users currently subscribe to services from the existing group of retail providers. The Wholesale Fiber Optic Network currently has about 16 internet service providers, four telephone service providers, and one video service provider, all of which are small local or regional companies. The retail service providers are charged for use of the Wholesale Fiber Optic Network system pursuant to a generally applicable rate schedule approved by the Commission. These wholesale rates are generally set by the Commission to allow the retail services to be competitive from a cost standpoint with other available options. The District currently is free from any significant Federal or State regulation with respect to the Wholesale Fiber Optic Network.

The Commission established financial goals for the Wholesale Fiber Optic Network and expectations for funding expansion over the next several years. In 2010 and 2011, the District spent \$10.50 million and \$5.1 million, respectively, for Wholesale Fiber Optic Network expansion and capital improvements. The approved capital budget for 2012 includes \$7.6 million and forecasts an additional \$5 million through 2013. The District experienced a 13.8% growth in wholesale fiber services revenue for December 2011 compared to December 2010.

The Wholesale Fiber Optic Network is operated and accounted for as part of the Electric System. Through the year ended December 31, 2011, the District had invested more than \$128 million in its telecommunications system facilities and equipment, including from Electric System bond proceeds and other available funds. This amount does not include the "backbone" part of the system that was built to serve internal District purposes, or net operating losses incurred by the Electric System with respect to the Wholesale Fiber Optic Network since it was first established. These net operating losses (including depreciation) currently amount to approximately \$4 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, 2011 AND 2010," including in particular Note 11, for additional financial and other information regarding the District's telecommunications system.

NoaNet

The District, along with 11 other Washington public utility districts and Energy Northwest, is a member of Northwest Open Access Network ("NoaNet"). NoaNet, a Washington nonprofit mutual corporation, was established in 2000 to provide its members with a broadband communications backbone throughout the State of

Washington using “public benefit” fibers leased by NoaNet from Bonneville. This was done to assist NoaNet’s members in the more efficient management of loads, energy conservation measures, and the acquisition of electric energy, as well as for other purposes. The network began commercial operations in 2001.

In 2001, NoaNet issued \$27 million in bonds to finance, among other things, the acquisition and construction of necessary facilities and systems. In June 2011, NoaNet issued \$13,165,000 to refund most of the NoaNet 2001 bonds. The Electric System has guaranteed the repayment of up to approximately \$2.67 million of NoaNet’s remaining 2001 bonds and the 2011 bonds (which amount includes a potential 25% step up if another member defaults) plus accrued interest. In addition, NoaNet has established approximately \$7.5 million of non-revolving lines of credit with a commercial lender in order to finance capital expenditures and network upgrades, of which the District has guaranteed, or to which the NoaNet board has pledged to assess the District for, the repayment of up to 17.57% of the outstanding balance to the extent NoaNet’s revenues are insufficient to pay the loans. The District contributed \$129,552 and \$70,300 to NoaNet in 2010 and 2011, respectively.

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 April 2012

System	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	\$ 151,735	\$ 156,070	\$ 151,735
Priest Rapids Development	2001-B	1/1/2023	12,335	8,220*		
	2003-A	1/1/2021	12,840	8,110*		
	2003-Z	1/1/2021	18,450	12,600		
	2005-A	1/1/2033	69,050	54,140		
	2005-B	1/1/2033	26,780	23,120		
	2005-Z	1/1/2033	43,685	35,640		
	2006-A	1/1/2036	24,770	22,350		
	2006-B	1/1/2017	5,470	2,900		
	2006-Z	1/1/2036	36,370	33,345	249,750	200,425
Wanapum Development	1999-D	1/1/2023	18,750	12,060*		
	2001-B	1/1/2023	16,465	10,980*		
	2003-A	1/1/2035	20,465	15,255*		
	2003-B	1/1/2035	16,680	14,075*		
	2003-Z	1/1/2021	20,135	13,755		
	2005-A	1/1/2038	52,325	47,155*		
	2005-B	1/1/2038	71,050	63,765		
	2005-Z	1/1/2018	4,405	2,575		
	2006-A	1/1/2043	71,395	64,895		
	2006-B	1/1/2031	18,190	13,665		
	2006-Z	1/1/2043	96,845	91,180	406,705	349,360
Priest Rapids Project	2010-A	1/1/2023	40,265	33,525		
	2010-B	1/1/2018	10,665	8,655		
	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	33,995	349,430	340,090
Total			<u>\$1,161,955</u>	<u>\$1,041,610</u>	<u>\$ 1,161,955</u>	<u>\$1,041,610</u>

* All or 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 2007 through 2011. 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)

	2007	2008	2009	2010	2011
Revenues					
Retail Energy Sales	\$ 101,135	\$ 111,186	\$ 114,864	\$ 122,900	\$ 134,804
Miscellaneous Electrical Revenues (1)	15,099	15,063	5,172	13,236	13,370
Sales to Other Utilities (2)	119,195	115,636	87,908	86,385	100,547
Total Revenues	\$ 235,429	\$ 241,885	\$ 207,944	\$ 222,521	\$ 248,721
Expenses					
Power Supply Costs (3)	\$ 93,327	\$ 109,808	\$ 127,015	\$ 148,349	\$ 143,769
Operation and Maintenance (4)	26,040	26,614	29,457	31,121	29,000
Taxes	7,887	8,395	8,800	8,983	10,153
Total Expenses	\$ 127,254	\$ 144,817	\$ 165,272	\$ 188,453	\$ 182,922
Net Revenues	\$ 108,175	\$ 97,068	\$ 42,672	\$ 34,068	\$ 65,799
Interest and Other Income	\$ 7,170	\$ 5,436	\$ 1,644	\$ 577	\$ 949
Transfer to the Rate Stabilization Account (5)	(48,000)	0	0	0	(20,000)
Revenues Available for Debt Service Less Debt Service (6)	67,345 (17,696)	102,504 (17,667)	44,316 (17,634)	34,645 (17,613)	46,748 (18,000)
Uncommitted Revenues	\$ 49,649	\$ 84,837	\$ 26,682	\$ 17,032	\$ 28,748
Beginning Working Capital	\$ 107,763	\$ 155,337	\$ 183,107	\$ 141,303	\$ 103,361
Bond Proceeds – Construction Fund	0	0	0	0	100,000
Funds Available for Construction Less Capital Construction	157,412 (36,651)	240,174 (46,849)	209,789 (61,570)	158,335 (36,611)	232,109 (27,018)
Change in Other Balance Sheet Accounts	34,576	(10,218)	(6,916)	(18,363)	(5,859)
Ending Working Capital (7)	\$ 155,337	\$ 183,107	\$ 141,303	\$ 103,361	\$ 199,232
Reserve and Contingency Fund (8)	\$ 92,199	\$ 94,319	\$ 95,072	\$ 96,118	\$ 71,806
Debt Service Coverage	3.81x	5.80x	2.51x	1.97x	2.60x
Retail Energy Sales (MWh)	3,247,536	3,529,922	3,715,666	3,878,154	4,038,608
Average Retail Energy Rate Increase	0%	0%	0%	4%	6%
Average Retail Revenue Requirement (cents/kWh)	3.11¢	3.15¢	3.09¢	3.17¢	3.34¢

(1) The District recognized earned contributions in aid of construction of \$8,660,241, \$8,871,577, \$993,576, \$9,058,551 and \$10,173,455 in 2011, 2010, 2009, 2008 and 2007, respectively.

(2) The decreases in 2010 and 2009 were related to depressed market prices and lower run-off.

(3) The increases in 2010 and 2009 were related to lower water flows for generation and increased power cost from the Priest Rapids Project.

(4) Excludes noncash items of depreciation and amortization.

(5) In 2007 and 2011, pursuant to Commission resolution, money was transferred to the Rate Stabilization Account from the Revenue Fund in the amount of \$48 million and \$20 million, respectively.

(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 is shown in the prior calendar year.

(7) Includes amounts in the construction funds.

(8) During 2010, pursuant to Commission resolutions, \$8,334,656 was transferred to the Reserve and Contingency Fund from the liquidation of the Future Generation Development Fund and \$7,500,000 was transferred from the Reserve and Contingency Fund into the Revenue Fund. In 2011, \$45.3 million from the Reserve and Contingency Fund was used to defease outstanding Electric System bonds. As of May 1, 2012, the balance in the Reserve and Contingency Fund was \$71.2 million.

The following table shows the Electric System's historical energy requirements, resources and power costs for fiscal years 2007 through 2011.

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

	2007	2008	2009	2010	2011
Annual Energy Requirements (MWh)					
Retail Sales (1)	3,256,927	3,553,474	3,693,343	3,878,190	4,058,471
Electrical System Usage	12,719	11,067	11,892	11,336	11,307
Sales for Resale (2)	3,337,221	4,020,567	3,111,968	2,777,244	3,282,143
Distribution/Transmission Line Losses	183,009	164,848	175,698	148,431	165,766
Total Energy Requirements	<u>6,789,876</u>	<u>7,749,956</u>	<u>6,992,901</u>	<u>6,815,201</u>	<u>7,517,687</u>
Annual Resources (MWh)					
Priest Rapids Project (3)	4,447,749	4,000,144	3,651,136	4,036,382	5,715,363
Quincy Chute Project	29,742	35,570	32,805	32,336	32,430
PEC Headworks Project	19,373	23,533	20,700	22,746	13,314
Bonneville/CSPE	1,714,918	1,718,103	1,704,937	1,704,796	1,352,243
Other (4)	578,094	1,972,606	1,583,323	1,018,941	404,337
Total Energy Resources	<u>6,789,876</u>	<u>7,749,956</u>	<u>6,992,901</u>	<u>6,815,201</u>	<u>7,517,687</u>
Average Power Cost by Resource (cents/kWh)					
Priest Rapids Project (3)	1.23¢	1.66¢	1.68¢	1.97¢	1.53¢
Quincy Chute Project	3.25	2.53	2.35	2.72	2.71
PEC Headworks Project	3.66	2.89	2.94	3.24	6.62
Bonneville/CSPE	2.40	2.38	2.64	2.79	2.61
Other	(1.99)	(0.22)	0.78	1.18	3.07
Annual Power Cost by Resource (\$000)					
Priest Rapids Project (3)	\$ 54,869	\$ 66,216	\$ 61,199	\$ 79,698	\$ 87,179
Quincy Chute Project	968	899	771	879	880
PEC Headworks Project	709	681	609	736	882
Bonneville/CSPE	41,187	40,923	45,039	47,566	35,282
Other (5)	(11,508)	(4,334)	12,338	11,997	12,427
Wheeling	7,102	5,423	7,059	7,473	7,119
Total Power Costs (\$000)	<u>\$ 93,327</u>	<u>\$ 109,808</u>	<u>\$ 127,015</u>	<u>\$ 148,349</u>	<u>\$ 143,769</u>
Average Power Costs (cents/kWh) (6)	1.37¢	1.42¢	1.82¢	2.18¢	1.91¢

- (1) Reflects total retail energy requirements.
- (2) The increase in 2008 was attributable to additional utility and market sales. Decreases in 2010 were due to decreased water for generation and low wholesale prices.
- (3) During 2010, pursuant to Commission resolution, the Priest Rapids Development and the Wanapum Development were combined into one system, the Priest Rapids Project. Prior year disclosures for the Priest Rapids Development and the Wanapum Development have been combined for comparative purposes.
- (4) The increases in 2008 and 2009 were necessary to satisfy the increase in annual energy requirements combined with a reduction of power resources received from the Priest Rapids Project during 2008 and 2009 compared to 2007 as a result of less power generation. Low production in 2010 was offset by greater production from the Priest Rapids Project.
- (5) By virtue of the New Power Sales Contracts, the Electric System's estimated unmet load is met through cash proceeds from the auction of power from the Priest Rapids Project. The Electric System's contractual share of these proceeds exceeded the actual power purchases necessary for 2007 and 2008.
- (6) The decreases in 2007 and 2008 were due to the Electric System having an increased share of the Priest Rapids Project. The Electric System was able to satisfy more load with Priest Rapids Project power.

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 2007 to 2011 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. The years 2007 and 2008 were exceptional years for generation of net operating revenue in the Electric System.

Near average run-off provided generation sufficient to meet the Electric System’s loads and provide ample surplus sales at healthy market prices. The years 2009 and 2010, while still profitable, reflected lower surplus sales revenues. Run-off 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 year 2011 had significant run-off (126% of average), and 2011 wholesale market prices continued to be low. This resulted in \$100 million in surplus sales and \$29 million in net operating revenues for the Electric System.

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

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

The Commission approved an 8% rate increase effective February 1, 2012, following 6% and 4% increases in 2011 and 2010, respectively. In addition, the Commission adopted a forecast with annual rate increases of 8% for the years 2013 through 2015, effective January 1 of each year. 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 an adequate reserve fund to help cushion rates from market volatility. These future rate increases may be modified to reflect future financial conditions.

Based on results to date and projections for the remainder of the year, the District expects that debt service coverage on Electric System bonds will be approximately 3.2 times in 2012.

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 2012-2014 to be \$173 million. The District currently does not anticipate additional bond financing to fund proposed capital improvements to the Electric System. The District is undertaking substantial capital improvements to serve expected load growth. See “THE ELECTRIC SYSTEM—Retail Energy Sales and Customers.”

Table 17
ELECTRIC SYSTEM PROJECTED
CAPITAL IMPROVEMENTS PROGRAM 2012-2014

Distribution	\$ 72,195,000
Transmission	65,869,000
Fiber	21,218,000
General Plant	13,661,000
	<u>\$ 172,943,000</u>

Various Factors Affecting the Electric Utility Industry

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

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

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 2011 population of 20,640 and Ephrata, the County seat, is the second largest with a 2011 population of 7,690. The County’s total population has grown from 74,698 in 2000 to 90,100 in 2011, an increase of over 20%. Population density in the County in 2011 was 33.63 persons per square mile ranking it 21st of the 39 counties in the State. The total civilian labor force in the County in 2012 is 40,890.

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

Following are economic indicators for the County.

Table 18
GRANT COUNTY
SELECTED ECONOMIC INDICATORS

	Population (1)	Per Capita Personal Income (2)	Taxable Retail Sales (\$000) (3)	Value of Building Permits (\$000) (4)	Personal Income (\$000) (2)
2011	90,100	—	\$ 623,913 (5)	\$ 51,426	—
2010	89,120	\$ 30,148	1,215,315	72,488	\$2,704,290
2009	86,100	29,145	1,225,954	41,432	2,545,522
2008	84,600	30,630	1,551,866	76,211	2,601,806
2007	82,500	27,439	1,537,951	121,243	2,267,736
2006	80,600	25,016	1,107,853	78,601	2,027,185
2005	79,100	24,138	872,602	78,572	1,919,739
2004	78,300	24,109	800,596	66,819	1,898,176
2003	77,100	23,453	744,458	52,264	1,828,312
2002	76,400	22,434	727,045	49,151	1,726,147
2001	75,900	21,927	772,135	48,521	1,667,391
2000	74,698	20,752	714,116	42,587	1,554,727

- (1) *Source:* Washington State Employment Security Department, Labor Market & Economical Analysis Branch; information for 2000 and 2010 are from the U.S. Bureau of the Census.
- (2) *Source:* Washington State Bureau of Economic Analysis; 2010 is most recent data available.
- (3) *Source:* Washington State Department of Revenue.
- (4) *Source:* Grant County Building Department.
- (5) Through the first half of 2011. For the first half of 2010, the taxable retail sales for the County were \$582,621,280.

Table 19
GRANT COUNTY MAJOR PROPERTY TAXPAYERS (1)

Taxpayer	Business	Assessed Valuation	% of County Assessed Valuation
REC Solar Grade Silicon, LLC	Chemical Manufacturing	\$ 1,053,048,000	11.82%
Microsoft Corporation	Data Center/Technology	399,507,825	4.48
Intuit Inc.	Data Center/Technology	185,705,035	2.08
Yahoo, Inc.	Data Center/Technology	165,505,390	1.86
J. R. Simplot	Potato Products	58,065,540	0.65
Inflation Systems	Air Bag Products	50,722,795	0.57
Lamb-Weston BSW, LLC	Potato Products	48,348,620	0.54
Conagra Foods Lamb-Weston Inc.	Potato Products	44,992,605	0.51
Columbia Colstor, Inc.	Cold Storage	44,886,490	0.50
BNSF Railway Company Tax Dept.	Railroads	42,656,118	0.48
Moses Lake Industries	Chemical Manufacturing	38,139,835	0.43
Guardian Fiberglass Inc.	Fiberglass	31,492,850	0.35
Chemi-Con Materials Corp.	Chemical Manufacturing	31,039,620	0.35
EKA Chemicals, Inc.	Chemicals	28,809,425	0.32
SGL Automotive Carbon Fibers LLC	Carbon Manufacturing	28,179,005	0.32
National Frozen Foods Corp.	Frozen Foods	24,831,940	0.28
Basic American Inc.	Potato Products	22,451,445	0.25
IAC Search & Media WA LLC	Data Center	19,527,350	0.22
Oregon Potato Company	Potato Products	18,754,495	0.21
Quincy Foods, LLC	Frozen Vegetables	17,500,485	0.20
William G. and Jeannette Evans	Real Estate	16,286,555	0.18
Moses Lake Farms LLC	Agriculture	15,011,205	0.17
Qwest Corporation Inc.	Telecommunications	14,924,263	0.17
Boeing Co.	Aerospace	12,985,375	0.15
Vintage Apartments LLC	Real Estate	12,809,510	0.14
		\$ 2,426,181,776	27.23%

(1) Total County assessed valuation for 2011 taxes is \$8,907,670,834.

Source: Grant County Assessor for tax collection year 2011; 2012 information is not yet available.

Table 20
GRANT COUNTY MAJOR EMPLOYERS

Employer	Product/Service	Employees
Moses Lake School District	Education	974
Grant County Government	Government	675
REC Silicon	Polysilicon Manufacturing	650
Wal-Mart	General Retail & Grocery Retail	615
The District	Electric Utility	600
Genie Industries, Inc.	Construction & Industrial Material Lifts & Aerial Work Platforms	600
Quincy Foods, LLC	Frozen Vegetable Processing	550
Quincy School District	Education	450
Samaritan Healthcare	Health Care	400
ConAgra Foods, Inc.	Frozen Potato Processing	400
Big Bend Community College	Education	300
J.R. Simplot Co.	Frozen French Fries & Dehydrated Potato Products	330
Ephrata School District	Education	310
Lamb Weston BSW	Frozen Potato Processing	300
Moses Lake Clinic	Health Care	266
Moses Lake Community Health	Health Care	264
Columbia Foods, Inc.	Corn & Peas Processing	250
Inflation Systems, Inc.	Automotive Air Bags	250
Columbia Basin Hospital	Health Care	200
Washington Potato Co.	Dehydrated Potato Flake Processing	200
Northwest Stone & Brick, LLC	Stone and Brick Processing	150
Moses Lake Industries, Inc.	Corporate Headquarters & Industrial Chemical	150
D&L Foundry, Inc.	Manhole Cover Manufacturing	125
Home Depot	Home Building & Repair Retail	72
International Paper	Corrugated Box Manufacturing	68

Source: Grant County Economic Development Council as of August 2010.

Table 21
GRANT COUNTY RESIDENT CIVILIAN LABOR FORCE AND EMPLOYMENT

	Annual Averages					
	2006	2007	2008	2009	2010	2011
Total Labor Force	38,610	40,140	40,820	42,270	41,900	41,900
Employment	36,100	37,830	38,210	38,100	37,360	37,700
Unemployment	2,510	2,310	2,610	4,170	4,540	4,200
Unemployment Rate	6.5%	5.8%	6.4%	9.9%	10.8%	10.0%

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

**Table 22
GRANT COUNTY NONAGRICULTURAL EMPLOYMENT**

NAICS Industry Title	Annual Averages					
	2006	2007	2008	2009	2010	2011
Total Nonfarm	26,060	26,960	26,870	25,690	25,390	26,360
Total Private	18,720	19,480	19,200	17,930	17,550	18,510
Goods Producing	5,480	5,860	6,230	5,430	5,200	5,620
Services Providing	20,580	21,110	20,640	20,250	20,190	20,740
Trade, Transport. & Utilities	5,060	5,260	5,390	5,390	5,380	5,520
Information & Financial Activities	990	1,020	1,020	960	1,000	1,120
Government	7,330	7,480	7,680	7,760	7,840	7,860

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

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

INITIATIVE AND REFERENDUM

Under the State Constitution, the voters of the State have the ability to initiate legislation and require a public vote on legislation passed by the State Legislature through the powers of initiative and referendum, respectively. Neither power may be used to amend the State Constitution. Initiatives and referenda are submitted to the voters upon certification of a petition signed by at least 8% (initiative) and 4% (referenda) of the number of voters registered and voting for the office of Governor at the preceding regular gubernatorial election. Any law approved in this manner by a majority of the voters may not be amended or repealed by the Legislature within a period of two years following enactment, except by a vote of two-thirds of all the members elected to each house of the Legislature. After two years, the law is subject to amendment or repeal by the Legislature in the same manner as other laws.

LIMITATIONS ON REMEDIES

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.

TAX MATTERS

The 2012A 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 2012A Bonds, interest on the 2012A Bonds is excluded from gross income for federal income tax purposes.

Continuing Requirements. The District is required to comply with certain requirements of the Code after the date of issuance of the 2012A Bonds in order to maintain the exclusion of the interest on the 2012A Bonds from gross income for federal income tax purposes, including, without limitation, requirements concerning the qualified use of 2012A Bond proceeds and the facilities financed or refinanced with 2012A Bond proceeds, limitations on investing gross proceeds of the 2012A Bonds in higher yielding investments in certain circumstances, and the requirement to comply with the arbitrage rebate requirement to the extent applicable to the 2012A 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 2012A Bonds could become taxable retroactive to the date of issuance of the 2012A 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 2012A 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 2012A 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 2012A 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 2012A Bonds may be subject to the foreign branch profits tax imposed by Section 884 of the Code when the 2012A 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 2012A 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 2012A Bonds. Depending on all the facts and circumstances and the type of audit involved, it is possible that commencement of an audit of the 2012A Bonds could adversely affect the market value and liquidity of the 2012A Bonds until the audit is concluded, regardless of its ultimate outcome.

2012A Bonds Not “Qualified Tax Exempt Obligations” for Financial Institutions. Section 265 of the Code provides that 100% of any interest expense incurred by banks and other financial institutions for interest allocable to tax exempt obligations acquired after August 7, 1986, will be disallowed as a tax deduction. However, if the tax exempt obligations are obligations other than private activity bonds, are issued by a governmental unit that, together with all entities subordinate to it, does not reasonably anticipate issuing more than \$30,000,000 of tax exempt obligations (other than private activity bonds and other obligations not required to be included in such calculation) in the current calendar year, and are designated by the governmental unit as “qualified tax exempt obligations,” only 20% of any interest expense deduction allocable to those obligations will be disallowed. The District has not designated the 2012A Bonds as “qualified tax exempt obligations.”

The District is a governmental unit that, together with all subordinate entities, reasonably anticipates issuing more than \$10,000,000 of tax exempt obligations (other than private activity bonds and other obligations not required to be included in such calculation) during the current calendar year and has **not** designated the 2012A 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 2012A Bonds is deductible for federal income tax purposes.

Original Issue Discount. The 2012A Bonds maturing in 2035 (with the interest rate of 3.75%) have been sold at prices reflecting original issue discount (“2012A Discount Bonds”). Under existing law, the original issue discount in the selling price of each 2012A Discount Bond, to the extent properly allocable to each owner of such 2012A Discount Bond, is excluded from gross income for federal income tax purposes with respect to such owner. The original issue discount is the excess of the stated redemption price at maturity of such 2012A Discount Bond over the initial offering price to the public, excluding underwriters and other intermediaries, at which price a substantial amount of the 2012A Discount Bonds of such maturity were sold.

Under Section 1288 of the Code, original issue discount on tax-exempt bonds accrues on a compound basis. The amount of original issue discount that accrues to an owner of a 2012A Discount Bond during any accrual period generally equals (i) the issue price of such 2012A Discount Bond plus the amount of original issue discount accrued in all prior accrual periods, multiplied by (ii) the yield to maturity of such 2012A Discount Bond (determined on the basis of compounding at the close of each accrual period and properly adjusted for the length of the accrual period), less (iii) any interest payable on such 2012A Discount Bond during such accrual period. The amount of original issue discount so accrued in a particular accrual period will be considered to be received ratably on each day of the accrual period, will be excluded from gross income for federal income tax purposes, and will increase the owner's tax basis in such 2012A Discount Bond. Any gain realized by an owner from a sale, exchange, payment or redemption of a 2012A Discount Bond will be treated as gain from the sale or exchange of such 2012A Discount Bond.

The portion of original issue discount that accrues in each year to an owner of a 2012A Discount Bond may result in certain collateral federal income tax consequences. The accrual of such portion of the original issue discount will be included in the calculation of alternative minimum tax liability as described above, and may result in an alternative minimum tax liability even though the owner of such 2012A Discount Bond will not receive a corresponding cash payment until a later year.

Owners who purchase 2012A Discount Bonds in the initial public offering but at a price different from the first offering price at which a substantial amount of those 2012A Discount Bonds were sold to the public, or who do not purchase 2012A Discount Bonds in the initial public offering, should consult their own tax advisors with respect to the tax consequences of the ownership of such 2012A Discount Bonds. Owners of 2012A Discount Bonds who sell or otherwise dispose of such 2012A Discount Bonds prior to maturity should consult their own tax advisors with respect to the amount of original issue discount accrued over the period such 2012A Discount Bonds have been held and the amount of taxable gain or loss to be recognized upon that sale or other disposition of 2012A Discount Bonds. Owners of 2012A Discount Bonds also should consult their own tax advisors with respect to state and local tax consequences of owning such 2012A Discount Bonds.

Original Issue Premium. The 2012A Bonds maturing in 2013 through 2029, inclusive, and 2035 (with the interest rate of 5.00%) have been sold at prices reflecting original issue premium (“2012A Premium Bonds”). An amount equal to the excess of the purchase price of a 2012A Premium Bond over its stated redemption price at maturity constitutes premium on such 2012A Premium Bond. A purchaser of a 2012A Premium Bond must amortize any premium over such 2012A 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 2012A Premium Bond will offset a like amount of qualified stated interest on such 2012A 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 2012A 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 2012A Premium Bond prior to its maturity. Even though the purchaser’s basis is reduced, no federal income tax deduction is allowed. Purchasers of 2012A 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 2012A Premium Bonds.

Reduction of Loss Reserve Deductions for Property and Casualty Insurance Companies. Under Section 832 of the Code, interest on the 2012A Bonds received by property and casualty insurance companies will reduce tax deductions for loss reserves otherwise available to such companies by an amount equal to 15% of tax exempt interest received during the taxable year.

Effect on Certain Social Security and Retirement Benefits. Section 86 of the Code requires recipients of certain Social Security and certain Railroad Retirement benefits to take receipts or accruals of interest on the 2012A Bonds into account in determining gross income.

Other Possible Federal Tax Consequences. Receipt of interest on the 2012A Bonds may have other federal tax consequences as to which prospective purchasers of the 2012A 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 2012A Bonds set forth above or adversely affect the market value of the 2012A 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 2012A Bonds. Prospective purchasers of the 2012A 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 2012A Bonds.

The 2012B 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 that must be satisfied subsequent to the issue date of the 2012B Bonds, interest on the 2012B Bonds (except any 2012B 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 2012B 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 after the date of issuance of the 2012B Bonds in order to maintain the exclusion of the interest on the 2012B Bonds from gross income for federal income tax purposes, including, without limitation, requirements concerning the qualified use of 2012B Bond proceeds and the facilities financed or refinanced with 2012B Bond proceeds, limitations on investing gross proceeds of the 2012B Bonds in higher yielding investments in certain circumstances, and the requirement to comply with arbitrage rebate requirements to the extent applicable to the 2012B 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 2012B Bonds could become taxable retroactive to the date of issuance of the 2012B 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 2012B 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 2012B Bonds are specified private activity bonds, and these alternative minimum tax provisions will apply to recipients of interest on the 2012B 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 2012B 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 2012B Bonds may be subject to the foreign branch profits tax imposed by Section 884 of the Code when the 2012B 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 2012B 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 2012B Bonds. Depending on all the facts and circumstances and the type of audit involved, it is possible that commencement of an audit of the 2012B Bonds could adversely affect the market value and liquidity of the 2012B Bonds until the audit is concluded, regardless of its ultimate outcome.

2012B 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 private activity bonds, such as the 2012B Bonds, acquired after August 7, 1986, will be disallowed as a tax deduction.

Original Issue Premium. The 2012B Bonds have been sold at prices reflecting original issue premium (“2012B Premium Bonds”). An amount equal to the excess of the purchase price of a 2012B Premium Bond over its stated redemption price at maturity constitutes premium on such 2012B Premium Bond. A purchaser of a 2012B Premium Bond must amortize any premium over such 2012B 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 2012B Premium Bond will offset a like amount of qualified stated interest on such 2012B 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 2012B 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 2012B Premium Bond prior to its maturity. Even though the purchaser’s basis is reduced,

no federal income tax deduction is allowed. Purchasers of 2012B 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 2012B Premium Bonds.

Reduction of Loss Reserve Deductions for Property and Casualty Insurance Companies. Under Section 832 of the Code, interest on the 2012B 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 2012B Bonds who are also recipients of certain Social Security and certain Railroad Retirement benefits to take receipts or accruals of interest on the 2012B Bonds into account in determining gross income.

Other Possible Federal Tax Consequences. Receipt of interest on the 2012B Bonds may have other federal tax consequences as to which prospective purchasers of the 2012B 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 2012B Bonds set forth above or adversely affect the market value of the 2012B 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 2012B Bonds. Prospective purchasers of the 2012B 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 2012B Bonds.

The 2012M Bonds and 2012Z Bonds

This advice was written to support the promotion or marketing of the 2012M Bonds and the 2012Z Bonds. This advice is not intended or written to be used, and may not be used, by any person or entity for the purpose of avoiding any penalties that may be imposed on any person or entity under the U.S. Internal Revenue Code of 1986, as amended (the “Code”). Prospective purchasers of the 2012M Bonds and the 2012Z Bonds should seek advice based on their particular circumstances from an independent tax advisor.

The following discussion generally describes certain aspects of the principal U.S. federal tax treatment of U.S. persons that are beneficial owners (“Owners”) of bonds who have purchased 2012M Bonds and 2012Z Bonds in the initial offering and who hold the 2012M Bonds and the 2012Z Bonds as capital assets within the meaning of Section 1221 of the Code. For purposes of this discussion, a “U.S. person” means an individual who, for U.S. federal income tax purposes, is (i) a citizen or resident of the United States, (ii) a corporation, partnership or other entity created or organized in or under the laws of the United States or any political subdivision thereof, (iii) an estate, the income of which is subject to U.S. federal income taxation regardless of its source of income, or (iv) a trust, if either: (A) a United States court is able to exercise primary supervision over the administration of the trust, and one or more United States persons have the authority to control all substantial decisions of the trust or (B) a trust has a valid election in effect to be treated as a United States person under the applicable treasury regulations.

This summary is based on the Code, published revenue rulings, administrative and judicial decisions, and existing and proposed Treasury regulations (all as of the date hereof and all of which are subject to change, possibly with retroactive effect). This summary does not discuss all of the tax consequences that may be relevant to an Owner in light of its particular circumstances, such as an Owner who may purchase 2012M Bonds and 2012Z Bonds in the secondary market, or to Owners subject to special rules, such as certain financial institutions, insurance companies, tax-exempt organizations, non-U.S. persons, taxpayers who may be subject to the alternative minimum tax or personal holding company provisions of the Code, or dealers in securities. **Accordingly, before deciding whether to purchase any 2012M Bonds and 2012Z Bonds, prospective purchasers should consult their own tax advisors regarding the United States federal income tax consequences, as well as tax consequences under the laws of any state, local or foreign taxing jurisdiction or under any applicable tax treaty, of purchasing, holding, owing and disposing of the 2012M Bonds and the 2012Z Bonds.**

In General – 2012M Bonds. As described herein under the heading DESCRIPTION OF THE BONDS— Designation of the 2012M Bonds as “New Clean Renewable Energy Bonds,”” the District has made an irrevocable election to have the 2012M Bonds, which are “qualified tax credit bonds” within the meaning of Section 54A(d) of the Code, treated as “specified tax credit bonds” within the meaning of Section 6431(f)(3) of the Code. As a result of these elections, interest on the 2012M Bonds is not excludable from the gross income of the Owners under Section 103 of the Code, and Owners of the 2012M Bonds will not be allowed any federal tax credits as a result of ownership of or receipt of interest payments on the 2012M Bonds.

In General – 2012Z Bonds. Interest on the 2012Z Bonds is not excludable from the gross income of the Owners for federal income tax purposes under Section 103 of the Code, and Owners of the 2012Z Bonds will not be allowed any federal tax credits as a result of ownership of or receipt of interest payments on the 2012Z Bonds.

Payments of Interest. Interest paid on the 2012M Bonds and the 2012Z Bonds will generally be taxable to Owners as ordinary interest income at the time it accrues or is received, in accordance with the Owner’s method of accounting for U.S. federal income tax purposes. Owners who are cash-method taxpayers will be required to include interest in income upon receipt of such interest payment; Owners who are accrual-method taxpayers will be required to include interest as it accrues, without regard to when interest payments are actually received.

Disposition or Retirement of 2012M Bonds and 2012Z Bonds. Upon the sale, exchange or other disposition of a 2012M Bond or a 2012Z Bond, or upon the retirement of a 2012M Bond or a 2012Z Bond (including by redemption), an Owner will recognize capital gain or loss equal to the difference, if any, between the amount realized upon the disposition or retirement (excluding any amounts attributable to accrued but unpaid interest, which will be taxable as such) and the Owner’s adjusted tax basis in the 2012M Bond or 2012Z Bond. Any such gain or loss will be United States source gain or loss for foreign tax credit purposes.

Defeasance of 2012M Bonds or 2012Z Bonds. If the District defeases any 2012M Bonds or 2012Z Bonds, such 2012M Bonds or 2012Z Bonds may be deemed to be retired and “reissued” for federal income tax purposes as a result of the defeasance. In such event, the Owner of a 2012M Bond or a 2012Z Bond would recognize a gain or loss on the 2012M Bond or the 2012Z Bond at the time of defeasance.

Backup Withholding. An Owner may, under certain circumstances, be subject to “backup withholding” (currently the rate of this withholding tax is 28%, but may change in the future) with respect to interest on the 2012M Bonds and the 2012Z Bonds. This withholding generally applies if the Owner of a 2012M Bond or a 2012Z Bond (i) fails to furnish the Bond Registrar or other payor with its taxpayer identification number; (ii) furnishes the Bond Registrar or other payor an incorrect taxpayer identification number; (iii) fails to report properly interest, dividends or other “reportable payments” as defined in the Code; or (iv) under certain circumstances, fails to provide the Bond Registrar or other payor with a certified statement, signed under penalty of perjury, that the taxpayer identification number provided is its correct number and that the Owner is not subject to backup withholding. Any amount withheld may be creditable against the Owner’s U.S. federal income tax liability and be refundable to the extent it exceeds the Owner’s U.S. federal income tax liability. The amount of “reportable payments” for each calendar year and the amount of tax withheld, if any, with respect to payments on the 2012M Bonds and the 2012Z Bonds will be reported to the Owners and to the Internal Revenue Service.

Reporting of Interest Payments. Subject to certain exceptions, interest payments made to beneficial owners with respect to the 2012M Bonds and the 2012Z Bonds will be reported to the IRS. Such information will be filed each year with the IRS on Form 1099, which will reflect the name, address and Taxpayer Identification Number of the beneficial owner. A copy of Form 1099 is required to be sent to each beneficial owner of a 2012M Bond or a 2012Z Bond.

ERISA CONSIDERATIONS

The Employees Retirement Income Security Act of 1974, as amended (“ERISA”), and the Code generally prohibit certain transactions between a qualified employee benefit plan under ERISA or tax-qualified retirement plans and individual retirement accounts under the Code (collectively, the “Plans”) and persons who, with respect to a Plan,

are fiduciaries or other “parties in interest” within the meaning of ERISA or “disqualified persons” within the meaning of the Code. All fiduciaries of Plans should consult their own tax advisors with respect to the consequences of any investment in the 2012M Bonds and the 2012Z 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 certain of 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 2012A Bonds, 2012B Bonds, 2012M Bonds and 2012Z Bonds from the District at Underwriters’ discounts of \$255,785, \$65,411, \$243,749 and \$73,502, respectively. The Underwriters’ obligations are subject to certain conditions precedent, and they will be obligated to purchase all 2012A Bonds, 2012B Bonds, 2012M Bonds and 2012Z 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. has informed the District that Citigroup Inc. and Morgan Stanley, the respective parent companies of Citigroup Global Markets Inc., one of the underwriters of the Bonds, and Morgan Stanley & Co. LLC, have entered into a retail brokerage joint venture. As part of the joint venture each of Citigroup Global Markets Inc. and Morgan Stanley & Co. LLC will distribute municipal securities to retail investors through the financial advisor network of a new broker-dealer, Morgan Stanley Smith Barney LLC. This distribution arrangement became effective on June 1, 2009. As part of this arrangement, Citigroup Global Markets Inc. will compensate Morgan Stanley Smith Barney LLC for its selling efforts in connection with its allocation of the Bonds.

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

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 pages 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.

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 designed 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 2013 for the Fiscal Year ended December 31, 2012):

(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 designed 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; and
- ◆ 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, (i) notice of such change will be given in the same manner as for a material event, and (ii) 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 complied with all prior written undertakings under the Rule.

RATINGS

Moody’s Investors Service (“Moody’s”), Standard & Poor’s Ratings Services (“S&P”) and Fitch Ratings (“Fitch”) have assigned their ratings of “Aa3,” “AA-,” 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. The District and the Underwriters undertake no responsibility either to bring to the attention of the owners of the Bonds any downward revision or withdrawal of any such rating or to oppose any such revision or withdrawal. 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.

PUBLIC UTILITY DISTRICT NO. 2
OF GRANT COUNTY, WASHINGTON

By _____ /s/ Thomas W. Flint
President of the Commission

By _____ /s/ Tim Culbertson
General Manager

[THIS PAGE INTENTIONALLY LEFT BLANK]

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 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 Bonds are deemed to have consented to this provision.

“Bonds” means the Priest Rapids Hydroelectric Project Revenue and Refunding Bonds, 2012 Series A, Series B, Series M and Series Z, 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.

“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 (the “Hydro Systems”), 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.

“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.

“New 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.

“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 2001 Priest Rapids Bonds, 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.

“Outstanding Wanapum Bonds” means the currently Outstanding 1999 Wanapum D Bonds, 2001 Wanapum Bonds, 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 Rating Services or their comparably recognized business successors or both Moody’s Investors Service and Standard & Poor’s Rating 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 New 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 with proceeds of the Bonds.

“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 the resolution authorizing such Future Parity Bonds; provided, however, that so long as any 2001 Priest Rapids Bonds or 2001 Wanapum Bonds are insured under a policy issued by Financial Security Assurance Inc. and such insurer is not in default thereunder, or 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 The Bank of New York Mellon Trust Company, N.A., Seattle, Washington, or such other Trustee as shall be appointed by the District.

“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.

“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.

“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.

“2003 Priest Rapids Bonds” means the \$31,290,000 principal amount of Priest Rapids Hydroelectric Development Second Series Revenue Bonds, 2003 Series A and Z authorized by Resolution No. 7603.

“2001 Priest Rapids Bonds” means the \$12,335,000 principal amount of Priest Rapids Hydroelectric Development Second Series Revenue Refunding Bonds, 2001 Series B authorized by Resolution No. 7486.

“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.

“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.

“2003 Wanapum Bonds” means the \$57,280,000 principal amount of Wanapum Hydroelectric Development Second Series Revenue Bonds, 2003 Series A, B and Z, authorized by Resolution No. 7604.

“2001 Wanapum Bonds” means the \$16,465,000 principal amount of Wanapum Hydroelectric Development Second Series Revenue Refunding Bonds, 2001 Series B authorized by Resolution No. 7487.

“1999 Wanapum D Bonds” means the \$20,000,000 principal amount of Wanapum Hydroelectric Development Second Series Revenue Refunding Bonds, 1999 Series D, authorized by Resolution No. 7268 and reoffered pursuant to Resolution No. 7496.

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 to pay or secure the payment of junior lien obligations.

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., Seattle, Washington is appointed to act as Trustee and hold the Interest Account and the Principal and Bond Retirement Account. The District may elect to hold the Interest Account and the Principal and Bond Retirement Account in lieu of having the Trustee hold the fund at any time. 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. The proceeds of the 2012M Bonds 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 2012M Bonds.

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, so long as any 2001 Priest Rapids and Wanapum Bonds are insured under a policy issued by FSA and such insurer is not in default thereunder, 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.

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 2012A Bonds and 2012B 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.

APPENDIX B

SUMMARY OF CERTAIN PROVISIONS OF THE POWER CONTRACTS

In 2001, the District executed power sales contracts with all of the purchasers of power under the Priest Rapids and Wanapum Development power sales contracts as well as with ten Idaho cooperatives, and a few additional amendments have since been made (as amended, the “New Power Sales Contracts”). The New 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 New Power Sales Contracts consist of a series of agreements signed with each of the Power Purchasers. The term of the New Power Sales Contracts is for the term of the new license received by the District for the Priest Rapids and Wanapum Developments (44 years).

Summaries of certain provisions of the New Power Sales Contracts are set forth below. Reference is made to the complete text of the New Power Sales Contracts for all of the provisions thereof. The major provisions of each of the New Power Sales Contracts are substantially similar except as to the percentages of 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 Development and Wanapum Development. Each Power Purchaser has the right of first refusal to purchase its proportionate part of the Priest Rapids Project output which is in excess of the actual and prospective needs of the District at that time for service to ultimate consumers within the service area of the District.

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 New 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 Agreements (as amended). The Product Agreements 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 requirements increase, the amount of power available to the Power Purchasers under the Product Agreements will decrease. The District will provide the Power Purchasers with an annual forecast of its requirements. If the District eventually requires 62% of the output from the Developments, the Power Purchasers will receive only the 8% slice resulting from elimination of the “Additional Product Sales Contract” under the Product Agreements

Reasonable Portion Agreements. The Reasonable Portion Agreements address the 30% of output from the Developments (the “reasonable portion”) that is reserved by the FERC for sale to other power customers in the region, as required by PL-544. The FERC order requires that this power be sold at market prices, and the Reasonable Portion Agreements provide that such sales will be made pursuant to a marketing plan approved by the Power Purchasers. The net revenue from sales of this “reasonable portion” of the output from the Priest Rapids Project will be distributed to the Power Purchasers in proportion to their participating shares under the Product Agreements. Once the District has taken the maximum amount of power allowed under the Product Agreements, it has rights to net revenues under the Reasonable Portion Agreements to provide for its firm energy requirements beyond that provided from the 62% allocation.

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 New 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 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 (most of which costs will be amortized over a 15-year period);

(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) Certain costs incurred by the District to fulfill obligations, if any, to parties to the 1959 Power Sales Contracts that do not sign a New Power Sales Contract; and

(9) 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) Revenue, if any, received as a result of the District’s fulfilling obligation to parties to the 1959 Power Sales Contracts that do not sign a New Power Sales Contract;

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

(D) 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, estimated cost to the District of selling the Displacement Product, risk premium allocable to the Power Purchaser, 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.

[THIS PAGE INTENTIONALLY LEFT BLANK]

APPENDIX C

**AUDITED FINANCIAL STATEMENTS OF THE DISTRICT
AS OF DECEMBER 31, 2011 AND 2010**

[THIS PAGE INTENTIONALLY LEFT BLANK]

Public Utility District No. 2 of
Grant County, Washington
Financial Statements
December 31, 2011 and 2010

PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

**INDEX
DECEMBER 31, 2011 AND 2010**

Report of Independent Auditors..... 1

Management’s Discussion and Analysis 2-8

Financial Statements

Balance Sheets 9-10

Statements of Revenues and Expenses and Changes in Net Assets 11

Statements of Cash Flows..... 12-13

Notes to the Financial Statements..... 14-48



Report of Independent Auditors

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

In our opinion, the accompanying balance sheets and the related statements of revenues and expenses and changes in net assets and of cash flows of the Public Utility District No. 2 of Grant County, Washington (the "District"), present fairly, in all material respects, the financial position of the District at December 31, 2011 and December 31, 2010, and its changes in financial position and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the District's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these financial statements 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 of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinions.

The management's discussion and analysis for the year ended December 31, 2011 on pages 2 through 8 is not a required part of the financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

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

PricewaterhouseCoopers LLP

April 24, 2012

PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

MANAGEMENT'S DISCUSSION AND ANALYSIS DECEMBER 31, 2011 AND 2010

As of December 31, 2011, 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. During 2010, per Commission resolution, Priest Rapids and Wanapum were combined into one system, the Priest Rapids Project.

Presented below is a discussion and analysis of the financial activities for the years ended December 31, 2011, 2010, and 2009. 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 Balance Sheets, Statements of Revenues and Expenses and Changes in Net Assets, Statements of Cash Flows, and the Notes to the Financial Statements.

The Balance Sheets include all of the District's assets, liabilities, and net assets 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 Assets. 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 September of 2011, the District defeased \$53 million of the Electric System 2001-H bonds. In October of 2011, the District also issued \$156.1 million of revenue and refunding bonds, at a net premium of \$20.8 million, associated with the Electric System to finance improvements in the Electric System, to refund certain bonds previously issued, to pay issuance costs, and to fund a debt service reserve. In April of 2010, the District issued \$349.4 million of bonds associated with the Priest Rapids Project to finance improvements at the Priest Rapids Project, to refund certain bonds previously issued, to pay issuance costs, and to fund a debt reserve. The District had revenue bonds

PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

MANAGEMENT'S DISCUSSION AND ANALYSIS

DECEMBER 31, 2011 AND 2010

outstanding of \$1.07 billion as of December 31, 2011 and 2010, and \$786.8 million as of December 31, 2009. See Note 5.

The Commission implemented rate increases to retail customers in April of 2010, February of 2011, and January of 2012 in the amounts of 4%, 6%, and 8%, respectively. The Commission adopted budget and forecast has future overall rate increases of 8% for the years 2013 – 2015. 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.

In December of 2001, the District signed the Priest Rapids Power Sales Contracts with the original power purchasers and 10 purchasers in Idaho for the purchase and sale of output from Priest Rapids and Wanapum. The Priest Rapids Power Sales Contracts consist of contracts with terms that extend through the new license term, March 31, 2052. The contract provisions relating to Priest Rapids took effect on November 1, 2005, and those relating to Wanapum took effect on November 1, 2009. In accordance with the Federal Energy Regulatory Commission ("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.

The Priest Rapids 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 less any interest earnings multiplied by the percentage of output or revenue, as applicable, that the purchaser is entitled to that year. Since November 1, 2005, the start of the new power sales contracts, the District has been able to meet all of its forecasted firm load requirements with Priest Rapids and Wanapum generation and other benefits derived from the Priest Rapids Project.

The District is a statutory preference customer of the Bonneville Power Administration ("BPA") and, as such has priority for power requirements over BPA's nonpreference customers. In 2011, 2010, and 2009 the District purchased 32%, 42%, and 44%, 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 new Priest Rapids Power Sales Contracts, the District has been providing Priest Rapids Project generation to some of its power purchasers at a similar price and quantity as what it received from BPA. This portion of the Power Sales Contracts expired on the same date the BPA contract expired, September 30, 2011. These

PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

MANAGEMENT'S DISCUSSION AND ANALYSIS

DECEMBER 31, 2011 AND 2010

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 2018. The existing generators are currently rated at 109.25 megavolt-amperes ("MVA"). The new generators will have a name plate rating of 128.6 MVA, an increase of 17.7%.

The District is in the process of a long-term turbine upgrade project at Wanapum Dam. In February of 2012, the eighth turbine and second generator were commissioned and began generating power. In April of 2011, the seventh turbine and the first generator were completed. The District anticipates replacing the remaining units at a rate of one every ten months, until all ten have been replaced, with a projected completion date of October of 2013 for turbines and May of 2018 for generators. As of December 31, 2011, the cost of the remaining Wanapum turbines and generators to be replaced is estimated at \$24.5 million and \$128.6 million, respectively.

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

Early in 2012, the District began entering into contracts to build a 35.3 mile 230 kV transmission line that spans from the Rocky Ford Substation to the Columbia intertie. This project is scheduled to begin construction September of 2012 and be in service early 2013. The estimated cost is \$45.1 million. The benefits include an improved ability to deliver power from the District's hydroelectric projects to customers, improves transmission reliability, and allows the District to better serve load growth.

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

Wanapum consists of a dam and hydroelectric generating station having a nameplate rating of 1,054,000 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, 2011, the Priest Rapids Project provided 9,573,895 megawatt hours ("MWh") of electric energy at an average cost of \$14.64 per MWh. During the year ended December 31, 2010, the Priest Rapids Project provided 7,060,574 MWh of electric energy at an

PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

MANAGEMENT'S DISCUSSION AND ANALYSIS DECEMBER 31, 2011 AND 2010

average cost of \$18.97 per MWh. During the year ended December 31, 2009, the Priest Rapids Project provided 7,576,725 MWh of electric energy at an average cost of \$15.36 per MWh.

While operating costs have remained generally consistent, the change in average costs per MWh at the Priest Rapids Project from 2009 to 2010 was driven by runoff water available for generation. In 2010, water for generation was even less than 2009. This decrease in water and the increase in debt service cost associated with the new bond issue resulted in a further increase in the cost per MWh in 2010. 2011 had considerably more water available for generation at 126% of average compared to 80% of average for 2010.

PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

MANAGEMENT'S DISCUSSION AND ANALYSIS DECEMBER 31, 2011 AND 2010 (AMOUNTS IN THOUSANDS)

CONDENSED COMPARATIVE FINANCIAL INFORMATION

Balance Sheet	2011	2010	2009
Assets			
Current	\$ 220,465	\$ 230,558	\$ 332,706
Net utility plant	1,408,063	1,330,747	1,208,167
Noncurrent	<u>351,944</u>	<u>342,023</u>	<u>58,024</u>
Total assets	<u>\$ 1,980,472</u>	<u>\$ 1,903,328</u>	<u>\$ 1,598,897</u>
Liabilities			
Current	\$ 128,352	\$ 134,241	\$ 140,600
Noncurrent	<u>1,112,883</u>	<u>1,087,524</u>	<u>798,202</u>
Total liabilities	<u>1,241,235</u>	<u>1,221,765</u>	<u>938,802</u>
Net assets			
Invested in capital assets, net of related debt	531,496	463,303	452,705
Restricted	74,869	60,672	34,831
Unrestricted	<u>132,872</u>	<u>157,588</u>	<u>172,559</u>
Total net assets	<u>739,237</u>	<u>681,563</u>	<u>660,095</u>
Total liabilities and net assets	<u>\$ 1,980,472</u>	<u>\$ 1,903,328</u>	<u>\$ 1,598,897</u>
Revenues and Expenses and Changes in Net Assets			
Operating revenues	\$ 293,065	\$ 267,897	\$ 256,129
Operating expenses	<u>204,608</u>	<u>216,241</u>	<u>204,027</u>
Net operating income	<u>88,457</u>	<u>51,656</u>	<u>52,102</u>
Other revenues (expenses)	(39,443)	(39,060)	(35,891)
Contributions in aid of construction	<u>8,660</u>	<u>8,872</u>	<u>994</u>
Change in net assets	<u>\$ 57,674</u>	<u>\$ 21,468</u>	<u>\$ 17,205</u>

PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

MANAGEMENT'S DISCUSSION AND ANALYSIS DECEMBER 31, 2011 AND 2010

FINANCIAL ANALYSIS

The following discussion provides comparative financial information for the years ended December 31, 2011, 2010, and 2009.

ASSETS

The \$102 million decrease in current assets from 2009 to 2010 is the result of the continued construction at the Priest Rapids Project and revenue financing of capital improvements in the Electric System combined with lower generation and price associated with surplus power sales. Current assets from 2010 to 2011 remained fairly constant.

Noncurrent assets remained relatively constant from 2010 to 2011. The \$284 million increase from 2009 to 2010 is due in large part to the proceeds from the 2010 bond offering and the associated debt service reserve.

In 2010, the District recognized a \$123 million increase in Net utility plant from the prior year. The continued growth of the Electric System and the replacement of turbines and generators at Wanapum and other improvements to Priest Rapids and Wanapum have required a considerable investment in plant. Net utility plant increased approximately \$77 million from 2010 to 2011.

LIABILITIES

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

In March of 2010, Standard & Poor's and Fitch Ratings reaffirmed the 'AA-/stable outlook' and 'AA/stable outlook', respectively, for the Electric System, Priest Rapids, Wanapum and the Priest Rapids Project System's bonds. Moody's, on the other hand, downgraded the District's bonds from 'Aa2' to 'Aa3/stable outlook'. In September of 2011, all three rating agencies reaffirmed their March of 2010 ratings and outlooks for the Priest Rapids, Wanapum, and the Priest Rapids Project System bonds and assigned an identical rating and outlook to the 2011-I bond issue for the Electric System. The strengths listed by all rating agencies included low-cost hydroelectric resources from the Priest Rapids Project and the willingness and ability of the District to raise retail rates as needed in the Electric System.

PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

MANAGEMENT'S DISCUSSION AND ANALYSIS DECEMBER 31, 2011 AND 2010

NET ASSETS

Net assets increased approximately \$21 million and \$17 million in 2010 and 2009, respectively. These are modest increases when compared to prior years and are indicative of the change in river flows for generation, market price for surplus generation, and increasing costs of purchased power for the Electric System. Net assets increased by over \$57 million in 2011. This is reflective of increased generation and surplus power sales due to exceptional river flows of 126% of average.

STATEMENT OF REVENUES AND EXPENSES

The Sales to power purchasers at cost is directly tied to power costs (operating expenses – noncash items + debt service – interest earnings). Additional expenses related to compliance with the new 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. During 2010, Sales to other utilities dropped from 2009 but only by \$1.5 million. This reflects another low generation year coupled with low wholesale prices. Most of the \$11.8 million increase in operating revenue came as the result of increased revenues from commercial and industrial customers. 2011's \$25.2 million increase in operating revenues resulted from more surplus power available for sales to other utilities coupled with retail rate increases and increased consumption, particularly in the commercial and industrial loads.

The expiration of the BPA block contract as of September 30, 2011, and increased generation from the Priest Rapids Project allowed the Electric System to purchase less power from other sources in 2011 to meet its loads. This resulted in a decrease of purchased power expense by over \$12 million compared to 2010. Operating expenses increased 6% from 2009 to 2010 partially due to increased purchased power expense and license compliance expense.

The decrease in Other revenues (expenses) from 2009 to 2010 is due to the increase in interest expense from the 2010 bond issue and the decrease in interest earning resulting from continued deterioration of interest rates. Other revenues (expenses) remained flat from 2010 to 2011.

Contributions in aid of construction ("CIAC's") for 2009 reflect normal levels of around \$1 million per year. In 2010 and 2011, CIAC's increased to nearly \$9 million with SGL Automotive and various data centers making up the majority of the contributions.

CONTACTING THE DISTRICT'S FINANCIAL MANAGEMENT

This report is designed to provide the District's ratepayers, 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

BALANCE SHEETS DECEMBER 31, 2011 AND 2010 (AMOUNTS IN THOUSANDS)

ASSETS	2011	2010
CURRENT ASSETS		
Cash	\$ 4,256	\$ 5,000
Investments	104,758	91,045
Restricted funds		
Cash	5,802	9,771
Investments	65,127	81,882
Customer accounts receivable, net of allowance for uncollectible accounts	19,105	18,030
Materials and supplies	19,819	20,490
Other current assets	1,598	4,340
	<hr/>	<hr/>
Total current assets	220,465	230,558
NONCURRENT ASSETS		
Investments	14,575	35,424
Restricted funds		
Cash	7,566	5,298
Investments	314,108	285,058
Unamortized debt expense	8,337	8,490
Conservation loans	713	550
Demand-side management	4,481	5,380
Deferred preliminary expenses	2,164	1,823
	<hr/>	<hr/>
Total other noncurrent assets	351,944	342,023
Utility plant, net of accumulated depreciation and amortization	1,408,063	1,330,747
	<hr/>	<hr/>
Total noncurrent assets	1,760,007	1,672,770
TOTAL ASSETS	<u>\$ 1,980,472</u>	<u>\$ 1,903,328</u>

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

PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

BALANCE SHEETS DECEMBER 31, 2011 AND 2010 (AMOUNTS IN THOUSANDS)

LIABILITIES AND NET ASSETS	2011	2010
CURRENT LIABILITIES		
Accounts payable		
Trade	\$ 33,165	\$ 31,086
Wages payable	11,917	13,067
Power purchasers	3,370	831
Accrued taxes	4,919	4,315
Customer deposits	2,966	3,108
Accrued bond interest	25,351	30,891
Unearned revenue	1,176	1,300
Habitat liability	10,253	8,163
Other current liabilities	40	20
Current portion of licensing obligations	3,675	5,630
Current portion of long-term debt	31,520	35,830
	<u>128,352</u>	<u>134,241</u>
Total current liabilities		
NONCURRENT LIABILITIES		
Accrued other postemployment benefits	1,068	919
Long-term unearned revenue	1,500	1,607
Licensing obligations, less current portion	47,384	48,410
Revenue bonds, less current portion	1,041,610	1,032,855
Unamortized (discount) premium, net	28,053	12,016
Unamortized refunding loss	(6,732)	(8,283)
	<u>1,112,883</u>	<u>1,087,524</u>
Total noncurrent liabilities		
Total liabilities	<u>1,241,235</u>	<u>1,221,765</u>
COMMITMENTS AND CONTINGENCIES (NOTES 6, 7, 8, 10, and 11)		
NET ASSETS		
Invested in capital assets, net of related debt	531,496	463,303
Restricted	74,869	60,672
Unrestricted	132,872	157,588
	<u>739,237</u>	<u>681,563</u>
Total net assets		
TOTAL LIABILITIES AND NET ASSETS	<u>\$ 1,980,472</u>	<u>\$ 1,903,328</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 ASSETS FOR THE YEARS ENDED DECEMBER 31, 2011 AND 2010 (AMOUNTS IN THOUSANDS)

	2011	2010
OPERATING REVENUES		
Sales to power purchasers at cost	\$ 53,005	\$ 54,247
Retail energy sales		
Residential	34,342	31,252
Irrigation	17,271	16,295
Commercial and industrial	82,185	74,372
Governmental and others	1,006	981
Sales to other utilities	100,547	86,385
Wholesale fiber optic network sales	3,415	3,027
Other	1,294	1,338
	293,065	267,897
OPERATING EXPENSES		
Purchased power	46,927	59,000
Generation	22,810	22,418
Transmission	11,363	11,184
Distribution	12,381	10,998
Customer and information services	4,659	6,367
Wholesale fiber optic network operations	1,214	1,451
Administrative and general	25,728	28,017
License compliance and related agreements	22,069	24,515
Depreciation and amortization	45,239	41,911
Taxes	12,218	10,380
	204,608	216,241
NET OPERATING INCOME	88,457	51,656
OTHER REVENUES (EXPENSES)		
Interest and other income	4,009	3,541
Interest on revenue bonds and other, net of capitalized interest of \$2,780 and \$3,083	(50,773)	(46,629)
Federal rebates on revenue bonds	7,123	4,828
Amortization of debt expense, discount, and premium	198	(800)
	(39,443)	(39,060)
CONTRIBUTIONS IN AID OF CONSTRUCTION	8,660	8,872
CHANGE IN NET ASSETS	57,674	21,468
NET ASSETS		
Beginning of year	681,563	660,095
End of year	\$ 739,237	\$ 681,563

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, 2011 AND 2010 (AMOUNTS IN THOUSANDS)

	2011	2010
CASH FLOWS FROM OPERATING ACTIVITIES		
Cash received from retail energy sales	\$ 134,288	\$ 124,229
Cash received from sales to power purchasers at cost	55,544	51,592
Cash received from sales to other utilities	99,350	103,261
Other cash receipts	5,052	4,431
Cash paid for customer deposits	(135)	(27)
Cash paid for purchase of power	(50,322)	(86,267)
Cash paid to contractors, suppliers, and employees	(92,309)	(111,655)
Taxes paid	(11,600)	(10,534)
	139,868	75,030
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Principal paid on revenue bonds	(36,043)	(33,105)
Interest paid on revenue bonds	(57,914)	(38,662)
Federal interest rebates	7,123	4,828
Bond proceeds	176,603	350,192
Payment on refunded debt	(64,477)	(35,568)
Payment on defeased debt	(54,409)	-
Bond issuance cost	(462)	(819)
Cash received from contributions in aid of construction	8,748	9,167
Licensing obligation payments	(5,592)	(3,064)
Acquisition and construction of plant assets	(115,015)	(147,090)
Proceeds on sale of plant assets	436	784
Miscellaneous nonoperating income	469	912
	(140,533)	107,575
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of investment securities	(529,134)	(781,773)
Sale proceeds of investment securities	533,761	604,240
Investment income proceeds	1,256	2,887
Net repurchase agreement	(7,500)	(5,000)
Cash paid for conservation loans	(163)	(140)
	(1,780)	(179,786)
NET (DECREASE) INCREASE IN CASH	\$ (2,445)	\$ 2,819

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, 2011 AND 2010 (AMOUNTS IN THOUSANDS)

	2011	2010
CASH AT END OF YEAR	\$ 17,624	\$ 20,069
CASH AT BEGINNING OF YEAR	<u>20,069</u>	<u>17,250</u>
NET (DECREASE) INCREASE IN CASH	<u>\$ (2,445)</u>	<u>\$ 2,819</u>
OPERATING ACTIVITIES		
Net operating income	\$ 88,457	\$ 51,656
Adjustments to reconcile net operating income to net cash provided by (used in) operating activities:		
Depreciation and amortization	45,239	41,911
Accretion expense	2,611	2,320
Earned revenue from deposits	(107)	(107)
Provision for uncollectible accounts	11	(27)
Cash provided by (used in) changes in operating assets and liabilities:		
Change in Habitat funds held in trust	2,130	1,983
Customer accounts receivable	(1,297)	19,083
Materials and supplies	672	(1,744)
Other current assets	2,739	1,243
Trade and wages payables	(3,773)	(15,100)
Payable to power purchasers, net	2,540	(26,434)
Accrued taxes	604	(208)
Customer deposits	(126)	(24)
Other current liabilities	19	-
Accrued other postemployment benefits	<u>149</u>	<u>478</u>
NET CASH PROVIDED BY OPERATING ACTIVITIES	<u>\$ 139,868</u>	<u>\$ 75,030</u>

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

PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

NOTES TO THE FINANCIAL STATEMENTS

DECEMBER 31, 2011 AND 2010

1. ORGANIZATION AND ACCOUNTING POLICIES

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

The District maintains its accounts in accordance with accounting principles generally accepted in the United States of America for proprietary funds as prescribed by the Governmental Accounting Standards Board (“GASB”). GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, requires that governmental utilities also follow accounting principles prescribed by the Financial Accounting Standards Board and predecessor organizations that are not in conflict with GASB pronouncements (“non-conflicting FASB standards”) and that were issued prior to November 30, 1989. It also permits governmental utilities to elect to follow all nonconflicting FASB standards issued after that date, which the District had elected not to do. 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. There are no new GASB pronouncements that would have a material impact on the District's financial results.

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.

PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

NOTES TO THE FINANCIAL STATEMENTS

DECEMBER 31, 2011 AND 2010

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.

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 nonoperating revenue at the point at which it becomes nonrefundable. The District recognized \$8.7 million and \$8.9 million of contributions in aid of construction for the years ended December 31, 2011 and 2010, respectively.

Allowance for Funds Used During Construction – Interest costs incurred to finance major construction projects are capitalized as part of the cost of the project. The composite interest rate for calculating capitalized interest was 3.68% and 4.44% for 2011 and 2010, respectively. Total capitalized interest was \$2.8 million and \$3.1 million during 2011 and 2010, 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 2.33% and 2.42% for 2011 and 2010, respectively. When utility plant assets are retired, their original cost, together with removal costs, less salvage, are charged to accumulated depreciation. The District does not collect costs of disposal through rates. Such costs are charged to accumulated depreciation.

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

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

Cash – For purposes of the statements of cash flows, the District classifies only amounts held in demand deposit accounts as cash.

PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

NOTES TO THE FINANCIAL STATEMENTS

DECEMBER 31, 2011 AND 2010

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.

All investment instruments, which are held in demand deposit accounts, are classified as investments. 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. Repurchase agreements are an overnight sweep account, which represents the primary difference between repurchase agreements and other investments.

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 Assets.

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

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

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

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

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

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

PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

NOTES TO THE FINANCIAL STATEMENTS

DECEMBER 31, 2011 AND 2010

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 Assets.

Net Assets – The District classifies its net assets 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 assets 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 consists of net 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 assets consists of net assets 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 estimates claims incurred but not reported are not significant as of December 31, 2011. There were no significant claims outstanding under this program at December 31, 2011.

Personal Leave Benefit – Employees of the District accrue a personal leave benefit based upon a years of service schedule. Personal leave may be used for vacation, sick leave, or other employee absences. The District records personal leave as an expense and a liability as earned. Unused personal leave may be accumulated up to a maximum of 1,200 hours for employees who began service prior to April 1, 2011. For employees hired on or after April 1, 2011, the accrued personal leave shall not exceed seven hundred (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

PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

NOTES TO THE FINANCIAL STATEMENTS

DECEMBER 31, 2011 AND 2010

reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates. The District has used significant estimates in determination of useful lives of DSM, unbilled revenue, Licensing obligations, allowance for uncollectible accounts, Accrued other postemployment benefits, and in the determination of depreciable lives of utility plant.

2. CASH AND INVESTMENTS

The District's cash deposits at December 31, 2011 and 2010, 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.

Cash and Investments are recorded 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, 2011 AND 2010

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

(amounts in thousands)	2011	2010
Unrestricted assets:		
Unrestricted funds:		
Revenue and Service System funds	\$ 50,619	\$ 34,176
Board designated funds:		
Electric System Reserve and Contingency fund	71,807	96,118
Self-Insurance Reserve fund	1,163	1,175
Total board designated funds	72,970	97,293
Total unrestricted funds	123,589	131,469
Restricted:		
Construction funds	257,923	257,969
Bond Sinking funds	40,942	39,492
Debt Service Reserve funds	32,195	19,471
Bond Interest funds	25,372	30,914
Renewal, Replacement and Contingency fund	23,978	24,242
Habitat funds	10,482	8,213
Quincy Chute Renewal and Replacement fund	1,711	1,708
Total restricted funds	392,603	382,009
Total	\$ 516,192	\$ 513,478

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

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

PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

NOTES TO THE FINANCIAL STATEMENTS

DECEMBER 31, 2011 AND 2010

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

The District's investments at December 31, 2011 and 2010, as identified on the Balance Sheets, 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 \$1.7 million and \$2.7 million for 2011 and 2010, respectively.

During 2011 and 2010, the District realized, in both years, \$1.9 million of interest earnings and realized gains from investments. The unrealized gain on investments held at December 31, 2011 and 2010 was \$1.8 million and \$405,204, respectively.

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

(amounts in thousands)	2011	2010
U.S. agencies	\$ 207,152	\$ 97,038
U.S. treasuries	177,432	294,486
Money market funds	52,522	51,917
Repurchase agreements	52,000	44,500
Municipal bonds	7,726	2,778
Total investments	<u>496,832</u>	<u>490,719</u>
Cash	<u>17,624</u>	<u>20,069</u>
Total cash and investments	<u>\$ 514,456</u>	<u>\$ 510,788</u>

PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

NOTES TO THE FINANCIAL STATEMENTS DECEMBER 31, 2011 AND 2010

The District places no limit on the amounts invested in any one issuer for federal agency securities. The following are the concentrations of risk greater than 5%, in either year. The credit ratings listed are from Fitch Ratings as of December 31, 2011. TSY refers to U.S. Treasury securities and N/R means not rated.

	Credit Rating	2011	2010
U.S. treasuries	TSY	36%	60%
FNMA Discount Notes	Aaa	17%	11%
Federal Home Loan Mortgage Corp.	Aaa	7%	Less than 5%
Money market funds	N/R	11%	11%
Repurchase agreements	N/R	11%	9%
Federal Home Loan Bank	Aaa	11%	Less than 5%
Federal Farm Credit	Aaa	7%	Less than 5%

3. UTILITY PLANT

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

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

PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

NOTES TO THE FINANCIAL STATEMENTS DECEMBER 31, 2011 AND 2010

(amounts in thousands)	Balance 2009	Additions	Retirements/ Transfers	Balance 2010
Distribution facilities	\$ 357,604	\$ 33,797	\$ (1,076)	\$ 390,325
Transmission facilities	151,661	3,282	-	154,943
Hydro facilities				
Power plant structures	43,745	3,030	-	46,775
Reservoirs, dams, waterways	372,926	220	-	373,146
Power plant equipment	318,895	20,359	(1,776)	337,478
General facilities				
Quincy Chute (Note 6)	17,683	-	-	17,683
Potholes East Canal (Note 6)	16,389	-	-	16,389
Other generation	30	-	-	30
General plant	221,755	29,631	(4)	251,382
FERC License	99,549	18,476	(7,379)	110,646
Other intangible assets	-	1,648	-	1,648
Total	<u>1,600,237</u>	<u>110,443</u>	<u>(10,235)</u>	<u>1,700,445</u>
Accumulated depreciation and amortization	<u>(587,725)</u>	<u>(42,933)</u>	<u>2,810</u>	<u>(627,848)</u>
Subtotal	1,012,512	67,510	(7,425)	1,072,597
Land and land rights	24,572	-	-	24,572
Construction in progress	<u>171,083</u>	<u>153,249</u>	<u>(90,754)</u>	<u>233,578</u>
Total net utility plant	<u>\$ 1,208,167</u>	<u>\$ 220,759</u>	<u>\$ (98,179)</u>	<u>\$ 1,330,747</u>

4. LICENSING

In 2008, the FERC issued the District a 44-year License for the continued operation of the Priest Rapids Project. Issuance of the license represented both the culmination of over a decade of work to obtain that authorization, and the beginning of several decades of significant new license implementation activities.

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

PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

NOTES TO THE FINANCIAL STATEMENTS

DECEMBER 31, 2011 AND 2010

In connection with being issued the license, the District agreed to numerous commitments related to fish and habitat protection which require payments to other organizations using funds provided by the District. During 2010, a present value of \$18.5 million of additional required future payments were recorded by the District. The present value of these obligations totaled \$51.1 million as of December 31, 2011, of which approximately \$3.7 million is expected to be paid within one year. The present value of the obligations was \$54.0 million as of December 31, 2010. These amounts are included in the FERC license balance and are reflected as liabilities in the balance sheets. The elements of these obligating payments, comprised of 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 September of 2011, the District used cash reserves to defease \$53 million of the Electric System 2001-H bonds. In October of 2011, the District also issued \$156.1 million of revenue and refunding bonds, at a net premium of \$20.8 million, associated with the Electric System to finance improvements in the Electric System, to refund certain bonds previously issued, to pay issuance costs, and to fund a debt service reserve. The refunded portion of \$62.8 million will yield a net present value savings of \$5.9 million.

In April of 2010, the District issued \$349.4 million of bonds associated with the Priest Rapids Project to finance improvements at the Priest Rapids Project, to refund certain bonds previously issued, to pay issuance costs, and to fund a debt reserve. The refunded portion of \$34.5 million will yield a net present value savings of \$2.9 million.

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

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

(amounts in thousands)	2011	2010
Electric System, interest rates of 1.5% to 5.0%, maturing through 2023	\$ 156,070	\$ 127,225
Priest Rapids Project, interest rates of 1.55% to 5.83%, maturing through 2043	<u>917,060</u>	<u>941,460</u>
Total revenue bonds outstanding	<u>\$ 1,073,130</u>	<u>\$ 1,068,685</u>

PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

NOTES TO THE FINANCIAL STATEMENTS DECEMBER 31, 2011 AND 2010

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

(amounts in thousands)	Principal	Interest	Total
2012	\$ 31,520	\$ 52,418	\$ 83,938
2013	39,660	52,849	92,509
2014	41,305	51,112	92,417
2015	39,815	49,214	89,029
2016	41,685	47,447	89,132
2017 – 2021	218,930	206,487	425,417
2022 – 2026	145,835	156,978	302,813
2027 – 2031	235,405	101,155	336,560
2032 – 2036	148,500	58,119	206,619
2037 – 2041	112,190	19,276	131,466
2042 – 2043	<u>18,285</u>	<u>1,453</u>	<u>19,738</u>
Total	<u>\$ 1,073,130</u>	<u>\$ 796,508</u>	<u>\$ 1,869,638</u>

The District is in compliance with all debt covenants related to the outstanding bonds, which includes debt service coverage, at December 31, 2011 and 2010.

PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

NOTES TO THE FINANCIAL STATEMENTS

DECEMBER 31, 2011 AND 2010

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

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

(amounts in thousands)	Balance 2009	Additions	Reductions	Balance 2010	Due Within One Year
Revenue bonds payable	\$ 786,830	\$ 349,430	\$ (67,575)	\$ 1,068,685	\$ 35,830
Unamortized premiums and discounts, net	11,499	2,142	(1,625)	12,016	-
Unamortized refunding loss	(9,435)	(2,073)	3,225	(8,283)	-
Total	\$ 788,894	\$ 349,499	\$ (65,975)	\$ 1,072,418	\$ 35,830

6. POWER PURCHASER COMMITMENTS

During the years ended December 31, the following resources were used to meet the District's load:

	2011	2010
BPA	32%	42%
Priest Rapids Project	37%	34%
Market and other	31%	24%
	<u>100%</u>	<u>100%</u>

PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

NOTES TO THE FINANCIAL STATEMENTS DECEMBER 31, 2011 AND 2010

Priest Rapids Project

The District met approximately 37% of its electric power loads for 2011 and 2010 through generation from the Priest Rapids Project. The balance of the load is met primarily through purchases from the Bonneville Power Administration (“BPA”) and from other resources or suppliers.

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 2011 and 2010, the District incurred 62% and 60% of Priest Rapids Project power costs with power purchasers funding 38% and 40%, respectively.

The District is committed to cover a minimum annual debt service requirement of approximately \$52 million over the next five years associated with the power costs at the Priest Rapids Project. Debt service requirements for the Priest Rapids Project currently extend through 2043.

From November 1, 2005, through September 30, 2011, under the provisions in the new power sales contracts, the District sold a portion of the Priest Rapids Project generation to displace the costs of purchasing BPA power. The net effect to the District was that the BPA portion of the District’s load was served at Priest Rapids Project power cost. Effective October 1, 2011, that portion of the power sales contract came to an end. With the expiration of the current BPA contract, as discussed below, the District retains the Priest Rapids Project generation it would otherwise have sold as a displacement to power costs. The District is therefore left in the same net resource and economic position.

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

PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

NOTES TO THE FINANCIAL STATEMENTS

DECEMBER 31, 2011 AND 2010

BPA

The District is a statutory preference customer of BPA. The District purchased power and transmission from BPA under contracts which expired September 30, 2011. BPA and the District agreed to a Shaped Block Purchase under which the District received 197 average megawatts (“aMW”) of energy for 9 months and 188 aMW of energy for 12 months for 2011 and 2010, respectively. The District also purchased approximately 5 aMW of energy for the Grand Coulee load during those periods. Block deliveries were fixed at a flat rate within each month, but predetermined at different levels each month to more closely follow anticipated seasonal load requirements. The District had 252 megawatts (“MW”) of transmission associated with this block purchase, which also expired on September 30, 2011. The District signed a follow-up contract during 2008 to serve its Grand Coulee load of approximately 5 aMW that expires September 30, 2028. The District has transmission to deliver the power associated with this load through September 30, 2028. In 2009, the District entered into a five-year agreement for 150 MW of Long-Term Firm (LTF) power with a security deposit of \$2.3 million for transmission services commencing January 1, 2011. 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.

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)

2012	\$	5,499
2013		5,940
2014		4,839
2015		2,570
2016		2,611

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.

PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

NOTES TO THE FINANCIAL STATEMENTS

DECEMBER 31, 2011 AND 2010

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

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

Yakama Nation Agreement

In 2007, the District entered into an agreement with 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 new license term. A primary consideration for settlement is an allocation of the benefit from the Priest Rapids Project to the Yakama Nation. The financial equivalent of 20 aMW for 2007-2009, 15 aMW for 2010-2015 and 10 aMW throughout the term of the agreement less the associated power costs is the benefit paid to the Yakama Nation. After 2015, the Yakama Nation can request to have actual physical power delivered. The Yakama Nation is responsible to pay the costs associated with producing the benefit received (either financial or physical delivery).

Other consideration to be provided by the Yakama Nation throughout the life of the agreement includes providing the District with right of first refusal to participate in the development of new generation resources, to cooperatively develop with the District the Pacific Lamprey and White Sturgeon Management Plans, and to represent itself on committees, subcommittees, and groups involved with implementation of the various agreements associated with the Priest Rapids Project and the new license requirements.

The agreement went into effect in 2007. The net payments to the Yakama Nation totaled \$825,668 and \$2.4 million during 2011 and 2010, respectively. These costs were charged to License compliance and related agreements expense.

The District's commitment to this agreement extends through the new license term (2052). The estimated average annual cost for this agreement is approximately \$1.5 million.

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.

PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

NOTES TO THE FINANCIAL STATEMENTS

DECEMBER 31, 2011 AND 2010

7. NONPOWER COMMITMENTS

Capital Projects

The District has contractual commitments relating to several Electric System capital improvement projects including fiber design/build, software replacement, electrical system upgrades, multiple transformer purchases, power cable purchases, substation and distribution line construction projects, and supplying cedar poles over the next few years totaling approximately \$10.7 million as of December 31, 2011.

The District's improvement programs for the Priest Rapids Project include restoration or replacement of generators and turbines, deleading and painting of six turbines, construction and upgrades to the maintenance and warehouse center, construction of a fish bypass project, and supplying transformers and digital hydraulic controls for the governor system as well as motor control centers. The District intends to, or has committed by contract to, fulfill these programs, which are projected to be substantially complete by early 2018. The contractually committed amount on future Priest Rapids Project work to be performed on these major capital programs is approximately \$162.5 million as of December 31, 2011.

Other Commitments

In 2006, the District entered into a Salmon and Steelhead Settlement Agreement with the United States Department of Interior, U.S. Fish and Wildlife Service, the National Marine Fisheries Service of the National Oceanic and Atmospheric Administration, 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.

In order to implement 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).

PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

NOTES TO THE FINANCIAL STATEMENTS DECEMBER 31, 2011 AND 2010

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 geared towards 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 the unanimous consent. Interest earned by the Habitat funds increase 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 river watersheds. The District anticipates funding these accounts up to and through the term of the new license.

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

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

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

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

PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

NOTES TO THE FINANCIAL STATEMENTS

DECEMBER 31, 2011 AND 2010

The District's total contributions to these Habitat funds for the years ended December 31, 2011, and December 31, 2010, equaled \$5.6 million and \$3.1 million, respectively. These contributions reduced the Licensing obligations, as discussed in Note 4.

The following table shows the District's estimate of the remaining fixed contributions to the Habitat funds as of December 31, 2011, representing required contributions through the New License term.

Estimated Fixed Habitat Funding Commitments

(amounts in thousands)

2012	\$	3,675
2013		3,897
2014		3,523
2015		3,547
2016		3,624
2017 and thereafter		96,887
Total	\$	<u>115,153</u>

Participation In Northwest Open Access Network, Inc. D.B.A. NoaNet - The District, along with 11 other Washington State Public Utility Districts and Energy Northwest, is a member of NoaNet, a Washington nonprofit mutual corporation. NoaNet was incorporated in February of 2000, to provide 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. The network began commercial operation in January of 2001.

In July of 2001, NoaNet issued \$27 million in Telecommunications Network Revenue Bonds (taxable) to finance the repayment of the founding members and the costs of initial construction, operations, and maintenance. During 2011, those bonds were refunded with new Revenue Bonds maturing between 2012 to 2016, with interest due semi-annually at rates ranging between .75% to 3.00%. The balance of the bonds outstanding as of December 31, 2011, was approximately \$13.1 million. Each member of NoaNet has entered into a Repayment Agreement to guarantee the bonds of NoaNet. The District's guarantee is limited to a maximum of 14.17% of the bonds. Additionally, NoaNet has obtained financing for other capital costs through notes payable, which have a total outstanding balance of \$1.4 million at December 31, 2011. NoaNet pledged future assessments, if necessary, to repay the notes payable, of which the District will pay its ownership share.

The management of NoaNet anticipates meeting its cost of operations through revenues but it has been necessary for NoaNet to assess members a fee to cover its debt obligations. The obligation paid in 2011 and 2010 by the District was \$70,300 and \$129,552, respectively.

PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

NOTES TO THE FINANCIAL STATEMENTS DECEMBER 31, 2011 AND 2010

For the NoaNet final 2011 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 available comprehensive annual financial report (CAFR) that includes financial statements and required supplementary information for each plan. The DRS CAFR may be obtained by writing to: Department of Retirement Systems, Communications Unit, P.O. Box 48380, Olympia, WA 98504-8380; or it may be downloaded from the DRS website at www.drs.wa.gov. The independent auditor for the District has not audited or examined any information in the CAFR, and accordingly, does not express an opinion or any other form of assurance with respect thereto. The following disclosures are made pursuant to GASB Statements No. 27, *Accounting for Pensions by State and Local Government Employers* and No. 50, *Pension Disclosures, an Amendment of GASB Statements No. 25 and No. 27*.

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

Plan Description

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

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

PERS members who joined the system by September 30, 1977, are Plan 1 members. Those who joined on or after October 1, 1977, and by either, February 28, 2002, for state and higher education employees, or August 31, 2002, for local government employees, are Plan 2 members unless they exercised an option to transfer their membership to Plan 3. PERS members joining the system on or after March 1, 2002, for state and higher education

PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

NOTES TO THE FINANCIAL STATEMENTS

DECEMBER 31, 2011 AND 2010

employees, or September 1, 2002, for local government employees have the irrevocable option of choosing membership in either PERS Plan 2 or PERS Plan 3. The option must be exercised within 90 days of employment. An employee is reported in Plan 2 until a choice is made. Employees who fail to choose within 90 days default to PERS Plan 3. Notwithstanding, PERS Plan 2 and Plan 3 members may opt out of plan membership if terminally ill, with less than five years to live.

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

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

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

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

PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

NOTES TO THE FINANCIAL STATEMENTS DECEMBER 31, 2011 AND 2010

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

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

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

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

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

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

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

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

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

- If they have at least ten service credit years and are 55 years old, the benefit is reduced by an ERF that varies with age, for each year before age 65.
- If they have 30 service credit years and are at least 55 years old, they have the choice of a benefit that is reduced by 3 percent for each year before age 65; or a benefit with a

PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

NOTES TO THE FINANCIAL STATEMENTS

DECEMBER 31, 2011 AND 2010

smaller (or no) reduction factor (depending on age) that imposes stricter return-to-work rules.

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

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

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

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

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

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

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

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

A one-time duty-related death benefit is provided to the estate (or duly designated nominee) of a PERS member who dies in the line of service as a result of injuries sustained in the

PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

NOTES TO THE FINANCIAL STATEMENTS

DECEMBER 31, 2011 AND 2010

course of employment, or if the death resulted from an occupational disease or infection that arose naturally and proximately out of said member's covered employment, if found eligible by the Department of Labor and Industries.

There are 1,197 participating employers in PERS. Membership in PERS consisted of the following as of the latest actuarial valuation date for the plans of June 30, 2010:

Retirees and Beneficiaries Receiving Benefits	76,899
Terminated Plan Members Entitled to But Not Yet Receiving Benefits	28,860
Active Plan Members Vested	105,521
Active Plan Members Nonvested	51,005
	<hr/>
Total	262,285
	<hr/> <hr/>

Funding Policy

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

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

PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

NOTES TO THE FINANCIAL STATEMENTS

DECEMBER 31, 2011 AND 2010

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

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

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

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

*** Plan 3 defined benefit portion only.

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

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

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

(amounts in thousands)	PERS Plan 1	PERS Plan 2	PERS Plan 3
2011	\$ 211	\$ 2,747	\$ 727
2010	147	2,378	628
2009	218	2,921	778

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.

PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

NOTES TO THE FINANCIAL STATEMENTS

DECEMBER 31, 2011 AND 2010

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 \$867,890 and \$870,721 in 2011 and 2010, 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 collective bargaining (for bargaining unit employees) and ratified by the District's Commission, or changed without bargaining for non-unit employees. The retiree subsidy plan does not issue a publicly available financial report.

Funding Policy

The District pays a percentage of the medical premiums based upon years of service of the retirees. At the age of 59½, the retiree is eligible for a subsidy of 3% of their premium cost for each year of service (including any partial year during the year of retirement) up to 30 years (years x 3% x retiree premium). The subsidy cannot be more than the premium amount paid for active employees and is effective until the retiree turns 65. For the years ended December 31, 2011 and 2010, the District paid approximately \$294,000 and \$206,000 in retiree subsidies, respectively.

PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

NOTES TO THE FINANCIAL STATEMENTS DECEMBER 31, 2011 AND 2010

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, 2011 and 2010:

(amounts in thousands)	2011	2010
Normal cost with interest	\$ 178	\$ 157
Amortization amount with interest	<u>265</u>	<u>337</u>
Annual required contribution	<u>\$ 443</u>	<u>\$ 494</u>
Annual OPEB cost	\$ 443	\$ 494
Less: benefit payments	<u>(294)</u>	<u>(206)</u>
Increase in net OPEB obligation	149	288
Temporary actuarial difference	-	190
Net OPEB obligation at beginning of year	<u>919</u>	<u>441</u>
Net OPEB obligation at end of year	<u>\$ 1,068</u>	<u>\$ 919</u>

Funded Status and Funding Progress

As of December 31, 2011 and 2010, the District's Actuarial Accrued Liability ("AAL") was \$4.1 million and \$5.2 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 2011 and 2010, the covered payroll (annual payroll of active employees covered by the plan) was \$50.7 million and \$52.8 million, respectively, and the ratio of the unfunded obligation to the covered payroll was 8.1% and 9.8%, 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

PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

NOTES TO THE FINANCIAL STATEMENTS

DECEMBER 31, 2011 AND 2010

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

Methods and Assumptions

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

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

Retirement age for active employees – Based on assumptions used by Washington Public Employees' Retirement System ("PERS") but adjusted to reflect expected future rates of retirement based on current experience of the District.

Mortality – Life expectancies were based on the RP 2000 combined active/retiree healthy mortality table for males and females.

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

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

10. CONTINGENCIES

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

11. SUPPLEMENTAL DISCLOSURE OF TELECOMMUNICATION ACTIVITIES

As described in Note 7, the District, along with 11 other Washington public utility districts and Energy Northwest, is a member of Northwest Open Access Network ("NoaNet"), a Washington nonprofit mutual corporation established in 2000. The network began commercial operation in January of 2001. NoaNet leases a fiber optic network from the Bonneville Power Administration and was created to assist in the development of a

PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

NOTES TO THE FINANCIAL STATEMENTS

DECEMBER 31, 2011 AND 2010

communications network to facilitate the utilities in the management of load, conservation, and acquisition of electrical energy. The network assists utilities in adapting high speed information technology systems to meet future customer needs.

The District is installing a fiber optic distribution system in its service area. This fiber optic distribution system is connected to NoaNet's fiber optic communication system. The District has made capacity on this system available to providers of high speed Internet services and telephone services, among others.

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

(amounts in thousands)	2011	2010
Operating revenues		
Wholesale fiber services	\$ 3,215	\$ 2,890
Dark fiber revenue	<u>200</u>	<u>137</u>
Wholesale fiber optic network sales	<u>\$ 3,415</u>	<u>\$ 3,027</u>
Operating expenses		
Administrative and general	\$ 557	\$ 543
Repairs and maintenance	657	908
Depreciation	<u>6,972</u>	<u>6,439</u>
Total operating expenses	<u>\$ 8,186</u>	<u>\$ 7,890</u>
Nonoperating revenues		
Contributions in aid of construction	\$ 127	\$ 165
Utility plant		
Additions to utility plant	\$ 5,112	\$ 10,498
Utility plant, net of accumulated depreciation	\$ 72,622	\$ 74,443

PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

NOTES TO THE FINANCIAL STATEMENTS

DECEMBER 31, 2011 AND 2010

12. SEGMENTS

The District has outstanding revenue bonds used to finance the Electric System, as well as 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 gross revenues only of the individual project or system that issued the bonds.

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

PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

NOTE 12 - SEGMENTS DECEMBER 31, 2011

CONDENSED BALANCE SHEET

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

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

PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

NOTE 12 - SEGMENTS FOR THE YEAR ENDED DECEMBER 31, 2011

SCHEDULE OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS

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

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

PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

NOTE 12 - SEGMENTS FOR THE YEAR ENDED DECEMBER 31, 2011

CONDENSED SCHEDULE OF CASH FLOWS

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

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

PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

NOTE 12 - SEGMENTS DECEMBER 31, 2010

CONDENSED BALANCE SHEET

(AMOUNTS IN THOUSANDS)	Electric System	Priest Rapids Project	Other	Total
ASSETS				
Total current assets	\$ 145,909	\$ 109,802	\$ (25,153)	\$ 230,558
Net utility plant	474,563	856,184	-	1,330,747
Noncurrent	44,283	297,740	-	342,023
TOTAL ASSETS	\$ 664,755	\$ 1,263,726	\$ (25,153)	\$ 1,903,328
LIABILITIES				
Current	\$ 42,548	\$ 116,846	\$ (25,153)	\$ 134,241
Noncurrent	119,986	967,538	-	1,087,524
TOTAL LIABILITIES	162,534	1,084,384	(25,153)	1,221,765
NET ASSETS				
Invested in capital assets, net of related debt	345,669	117,634	-	463,303
Restricted	13,138	47,534	-	60,672
Unrestricted	143,414	14,174	-	157,588
TOTAL NET ASSETS	502,221	179,342	-	681,563
TOTAL LIABILITIES AND NET ASSETS	\$ 664,755	\$ 1,263,726	\$ (25,153)	\$ 1,903,328

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

PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

NOTE 12 - SEGMENTS DECEMBER 31, 2010

SCHEDULE OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS

(AMOUNTS IN THOUSANDS)	Electric System	Priest Rapids Project	Other	Total
OPERATING REVENUES	\$ 213,650	\$ 133,945	\$ (79,698)	\$ 267,897
OPERATING EXPENSES				
Depreciation and amortization	26,927	14,984	-	41,911
Other operating expenses	188,453	65,575	(79,698)	174,330
Total operating expenses	215,380	80,559	(79,698)	216,241
NET OPERATING (LOSS) INCOME	(1,730)	53,386	-	51,656
OTHER REVENUES (EXPENSES)				
Interest and other income	576	2,965	-	3,541
Interest on revenue bonds and other, net of capitalized interest of \$3,083	(6,765)	(39,864)	-	(46,629)
Federal rebates on revenue bonds	-	4,828	-	4,828
Amortization of debt expense, discount, and premium	450	(1,250)	-	(800)
Total other revenues (expenses)	(5,739)	(33,321)	-	(39,060)
CONTRIBUTIONS IN AID OF CONSTRUCTION	8,872	-	-	8,872
CHANGE IN NET ASSETS	1,403	20,065	-	21,468
NET ASSETS				
Beginning of year	500,818	159,277	-	660,095
End of year	\$ 502,221	\$ 179,342	\$ -	\$ 681,563

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

PUBLIC UTILITY DISTRICT NO. 2 OF GRANT COUNTY, WASHINGTON

NOTE 12 - SEGMENTS DECEMBER 31, 2010

CONDENSED SCHEDULE OF CASH FLOWS

(AMOUNTS IN THOUSANDS)	Electric System	Priest Rapids Project	Other	Total
Net cash provided by operating activities	\$ 1,035	\$ 43,655	\$ 30,340	\$ 75,030
Net cash (used in) provided by capital and related financing activities	(44,954)	144,881	7,648	107,575
Net cash provided by (used in) investing activities	36,620	(190,048)	(26,358)	(179,786)
NET (DECREASE) INCREASE IN CASH	<u>\$ (7,299)</u>	<u>\$ (1,512)</u>	<u>\$ 11,630</u>	<u>\$ 2,819</u>
CASH AT END OF YEAR	\$ 14,010	\$ 10,597	\$ (4,538)	\$ 20,069
CASH AT BEGINNING OF YEAR	21,309	12,109	(16,168)	17,250
NET (DECREASE) INCREASE IN CASH	<u>\$ (7,299)</u>	<u>\$ (1,512)</u>	<u>\$ 11,630</u>	<u>\$ 2,819</u>

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

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, 2012
Series A (Not Subject to AMT) — \$54,510,000
Series B (Subject to AMT) — \$16,235,000
Series M (Taxable New Clean Renewable Energy Bonds – Direct Payment) — \$42,395,000
Series Z (Taxable) — \$14,480,000

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 Refunding Bonds, 2012 Series A (Not Subject to AMT), in the aggregate principal amount of \$54,510,000 (the “2012A Bonds”), Priest Rapids Hydroelectric Project Revenue Refunding Bonds, 2012 Series B (Subject to AMT), in the aggregate principal amount of \$16,235,000 (the “2012B Bonds”), Priest Rapids Hydroelectric Project Revenue Bonds, 2012 Series M (Taxable New Clean Renewable Energy Bonds – Direct Payment), in the aggregate principal amount of \$42,395,000 (the “2012M Bonds”) and Priest Rapids Hydroelectric Project Revenue Refunding Bonds, 2012 Series Z (Taxable), in the aggregate principal amount of \$14,480,000 (the “2012Z Bonds” and, collectively with the 2012A Bonds, the 2012B Bonds and the 2012M 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. 8625 of the District’s Board of Commissioners (the “Bond Resolution”) to finance improvements to the Priest Rapids Project, to refund certain outstanding Priest Rapids Development and Wanapum Development revenue bonds, to fund the Reserve Account and to pay 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 2012A Bonds and 2012B Bonds in order to maintain the exclusion of the interest on the 2012A Bonds and 2012B Bonds from gross income for federal income tax purposes, including, without limitation, requirements concerning the qualified use of 2012A Bonds and 2012B Bond proceeds and the facilities financed or refinanced with 2012A Bonds and 2012B Bond proceeds, limitations on investing gross proceeds of the 2012A Bonds and 2012B Bonds in higher yielding investments in certain circumstances and the arbitrage rebate requirement to the extent applicable to the 2012A Bonds and 2012B 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 2012A Bonds and 2012B Bonds could become taxable retroactive to the date of issuance of the 2012A Bonds and 2012B 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 2012A Bonds with applicable requirements of the Code, the interest on the 2012A Bonds is excluded from gross income for federal income tax purposes and is not an item of tax preference for purposes of the alternative minimum tax applicable to individuals; however, while interest on the 2012A Bonds also is not an item of tax preference for purposes of the alternative minimum tax applicable to corporations, interest on the 2012A 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 received by certain S corporations may be subject to tax, and interest on the 2012A Bonds received by foreign corporations with United States branches may be subject to a foreign branch profits tax; and such exclusion is not available with respect to interest on any 2012A Bond for any period during which such 2012A Bond 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. We express no opinion regarding any other federal tax consequences of receipt of interest on the 2012A Bonds.

5. Assuming compliance by the District after the date of issuance of the 2012B Bonds with applicable requirements of the Code, under existing federal law, the interest on the 2012B Bonds is excluded from gross income for federal income tax purposes, however such exclusion is not available with respect to interest on any 2012B Bond for any period during which such 2012B Bond 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; interest 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; interest on the 2012B Bonds received by certain S corporations may be subject to tax, and interest on the 2012B 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 2012B Bonds.

6. Interest on the 2012M Bonds and 2012Z Bonds is not excludable from gross income for federal tax purposes.

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

[THIS PAGE INTENTIONALLY LEFT BLANK]

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.

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.

[THIS PAGE INTENTIONALLY LEFT BLANK]

[THIS PAGE INTENTIONALLY LEFT BLANK]

