

Message from the Superintendent



"We will keep our eyes fixed on the twin financial targets of reducing debt and increasing cash reserves."

Jorge Carrasco
Superintendent
Seattle City Light

This has been my first year as City Light Superintendent. It has been an exciting and challenging year, full of the joy that comes with living in one of America's most lovely and vibrant cities. I have spent a lot of my time getting to know our new city, the issues facing our customers, and, most importantly, the people who work at City Light. I've found that our employees have high expectations for the organization. They want to work for a top-performing utility, and they are ready to accept the challenge of getting theirs to perform at the top level. Based on surveys and countless conversations, they seek a cultural change that leads us to a more collaborative workplace, with employees empowered at all levels, focused on doing the best for their customers.

Financially, we need to create value for our shareholders: our customers and the citizens of Seattle, Shoreline, Burien, Lake Forest Park and Tukwila. I believe that one of our biggest challenges is to make sure public power stays competitive. So as we transform, we will be cost conscious and efficient. We will stay within our budget. We will spend money where it's needed, but we will not waste money. We will keep our eyes fixed on the twin financial targets of reducing debt and increasing cash reserves.

I am fortunate to be working with strong Seattle leadership. Mayor Nickels understands the utility industry and is interested in its issues. The City Council gives City Light the personal and institutional time to get our often complicated messages across. The Advisory Board offers top business and industry talent and many, many hours of their time. Together, they are aligned with a clear view of the utility's top priorities:

- Ensuring the long-term financial stability of the utility, especially considering the significant debt incurred in the past, limited cash reserves, and an increasingly volatile operating environment.
- Enhancing the reliability of service through a balanced resource portfolio, reliable transmission and distribution facilities, and better risk management processes.
- A commitment to customers.
- Preparing our workforce for the competitive environment facing our industry.
- Balancing all of the above with the need to maintain stable, affordable rates.

I'm confident that City Light's financial and cultural transformations, enhanced by effective, informed City leadership, will create a strong utility and a high-performance workplace that puts City Light in the top tier of public utilities.

Jorge Carrasco



TRANSFORMATION Overview

Seattle City Light entered the year with a steadily improving financial outlook and a new commitment to organizational improvement. Transformation was both a goal and a process for Seattle City Light in 2004.

The year began with the publication of the Seattle City Light Advisory Board's first annual report, acknowledging City Light's recovery from the West Coast energy crisis. The report recommended that the utility continue to strengthen its financial condition, improve its risk management processes, implement strategic and resource planning, and strengthen its organizational and management systems and practices to help it become a high-performance organization. Much of City Light's activities in 2004 were undertaken to keep the utility on that path.

Jorge Carrasco took the City Light helm in February. The new superintendent began working immediately on one of his and the Advisory Board's priorities: an initiative designed to transform City Light into a high-performance organization.

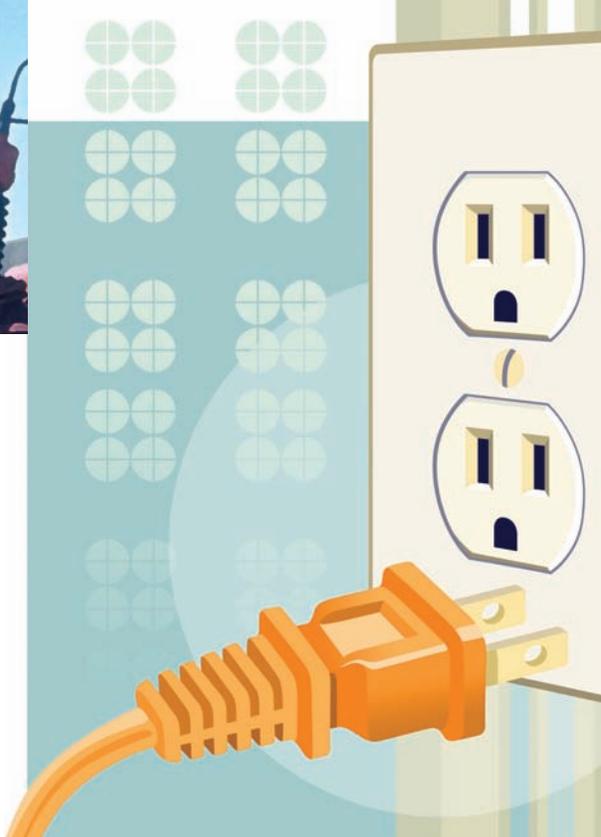
The organizational transformation began with an internal survey, completed by 74 percent of the utility's employees and designed to identify workplace issues and improvements.

In June, City Light discussed the survey results at employee-led meetings with all 42 of the utility's work groups, including those at the Skagit and Boundary hydroelectric facilities. Each work group produced a written report on the results of the discussions. Issues and strategies were further refined by employee focus groups in August.

Many issues identified in the survey were addressed quickly within individual workgroups. Cross-divisional issues became part of longer-term action plans. All City Light managers signed a commitment in late 2004 to implement the plans, and the utility began preparing for a follow-up employee survey for 2006.

With winter came the retirements of four members of City Light's executive team: Jim Ritch, Finance and Administration; Dana Backiel, Generation; Mike Sinowitz, Power Management; and Nancy Glaser, Strategic Planning/Environment & Safety.

Superintendent Carrasco took the opportunity to make significant changes in the organizational structure of City Light and to the composition of the senior leadership team. They also responded to the expectations of the mayor and Seattle City Council, the City Light Advisory Board, the results of the employee survey and the recommendations of the strategy team. All were aligned with one message - creating a high-performance organization.



The new organizational design focused more strategically on the four key elements of City Light's work:

- **Producing Power**
- **Serving Customers**
- **Managing money and risk**
- **Supporting employees**

Carrasco reduced his direct reports from nine to four. They are:

- **Power Supply & Environmental Affairs Officer** - responsible for all functions related to power generation, including power plant operations, power marketing, integrated resource planning and licensing.
- **Customer Service & Energy Delivery Officer** - responsible for managing activities related to the delivery of our product to our customers, including all power distribution, account and customer services, and the System Control Center.
- **Chief Financial Officer** - responsible for our financial affairs, risk management, strategic planning and information technology.
- **Human Resources Officer** - responsible for all functions supporting employees, including Safety and the Apprenticeship Program.



He also created an Office of the Superintendent, which will include Public Affairs and Communications, External Affairs, a Chief of Staff to handle City Council and Advisory Board coordination, and the daily logistics of the office such as scheduling and correspondence.

In November, Carrasco brought on Bill Gaines, an experienced resource expert from Puget Sound Energy, to handle the power marketing function. In December, he named John Prescott, former Vice President for Power Supply at Idaho Power, as City Light's new Power Supply Officer. Searches were under way for candidates to fill the other officer positions.

Phase II of City Light's transformation - structural reorganization at the division level - was scheduled to begin in January 2005.

Meanwhile, as organizational change proceeded, City Light continued steadily in 2004 toward the milestones that would trigger strong, new financial policies in 2005.

Financial Highlights

Net Income Realized

At the end of 1999, Seattle City Light reported net income of \$7.7 million for the year. Then along came the Western energy crisis - marked by market manipulation and drought - and four straight years of net losses.

City Light spent more than \$500 million on wholesale market power in 2000-2001. The rates in place at the time assumed \$20 million for that energy. The utility relied on a combination of rate increases and short-term borrowing to cover the cost. In 2001, it issued two-year revenue anticipation notes (\$182.2 million) and borrowed \$100 million from the City of Seattle's consolidated cash pool. City Light replaced its cash pool loan in 2002 with lower-interest, one-year revenue anticipation notes (\$125 million).

Since then, City Light has passed several milestones on the road to recovery. The utility had retired all short-term notes by November 2003 and ended the year owing \$70 million to the city's cash pool, which it continued to use for cash-flow management. That debt was paid off in May 2004. At the end of 2004, City Light recorded net income of \$13.8 million, its first net income since 1999.

Energy Revenue

City Light achieved net income despite having less surplus energy to sell on the wholesale market in 2004. Because of low precipitation and stream flows in the Northwest, surplus energy was 35.7 percent below the forecast, which had assumed normal water. Higher-than-expected market prices partially offset the effect of low water. Net wholesale revenue of \$113.6 million was 21.2

percent below the adopted forecast. Retail revenue was 0.9 percent above the adopted forecast.

Long-term Borrowing/Credit Rating

City Light issued new long-term debt in 2004 and refinanced some outstanding debt to reduce long-term debt cost.

In December, the utility sold \$284.855 million of bonds with a true interest cost of 4.23 percent. City Light will use \$60 million of the issue to finance capital projects and conservation programs. The rest was used to refinance certain bonds issued in 1995, 1996 and 1999, achieving a \$14.7 million savings in net present value for ratepayers.

Both Moody's Investor Services and Standard & Poor's (S&P) upgraded the financial outlook for City Light and affirmed their strong ratings for the utility.

Standard & Poor's affirmed its 'A' rating and raised its outlook for City Light two notches, from negative to positive. Moody's affirmed its 'Aa3' credit rating and hiked the utility's outlook from negative to stable.

S&P said its rating "reflects Seattle City Light's fundamental credit strengths, improved financial position, and full recovery of deferred power costs incurred in 2001." The agency noted that in 2004, City Light "met its objective of retiring its short-term debt and rebuilding cash reserves to adequate levels ..."

Moody's said that the change from a negative to a stable credit outlook "reflects that Seattle City Light has emerged from a period of financial stress,

"Its rating reflects Seattle City Light's fundamental credit strengths, improved financial position, and full recovery of deferred power costs incurred in 2001."

Standard & Poor's



demonstrating in the process its financial resiliency.” Moody’s credited City Light for adopting and adhering to a “decisive” financial plan for recovery from the energy crisis of 2000-2001. In 2004, “all short-term debt had been repaid and operating reserves were built back up to better protect against a certain level of risk exposure.”

“The credit outlook has been changed to stable from negative given the progress the utility has achieved in restoring its financial health,” Moody’s said.

Streetlight Refunds

In December 1999, the City of Seattle decided to have City Light pay the cost of maintaining streetlights, and the utility began billing customers for that service. In November 2003, the Washington State Supreme Court ruled that arrangement illegal under the state’s constitution. Funds paid by municipal utility customers for utility services must remain separate from funds paid by taxpayers for general government activities, the court ruled. The court said that streetlight maintenance should be a cost of general government rather than a utility expense. It ordered the City to reimburse City Light for the \$24 million the utility paid for streetlights between 1999 and 2003.

The issue went back to King County Superior Court to resolve details. In May 2004, the judge in the case found that monies repaid to City Light by the City should be refunded to customers. By the fall, City Light had developed and implemented a process whereby current and past residential customers of the utility could apply for streetlight refunds. City Light estimated that refunds would average about \$30-60 per customer.

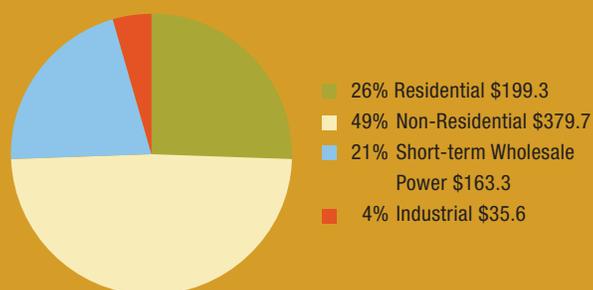
2004 Highlights

Financial (in millions)	2004	2003	% Change
Total operating revenues	\$ 777.9	\$ 739.0	5.3
Total operating expenses	710.0	700.1	1.4
Net operating income	67.9	38.9	74.6
Investment income	2.5	3.8	(34.2)
Interest expense, net	(76.3)	(77.0)	(0.9)
Other income, net	1.8	0.1	100+
Fees and grants	17.9	26.1	(31.4)
Net income (loss)	\$ 13.8	\$ (8.1)	(100+)
Debt service coverage, prior lien bonds	1.58	1.56	1.3
Debt service coverage, prior lien bonds ^A	2.39	2.50	(4.4)

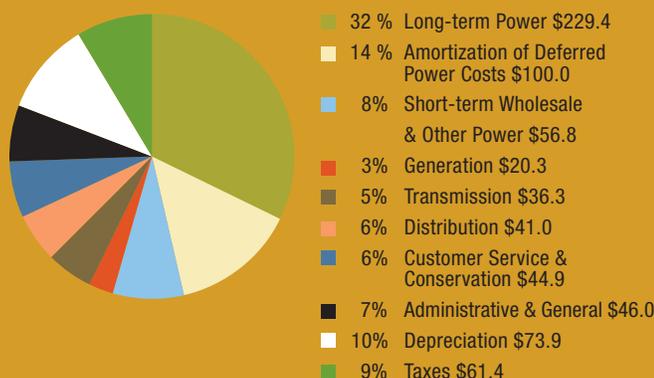
^A Debt Service Coverage computation, without the effect of \$100.0 million annual amortization of \$300.0 million power costs deferred in 2001, for informational purposes only.

Energy	2004	2003	% Change
Total generation	6,019,707 MWh	6,098,753 MWh	(1.3)
Firm energy load	9,560,928 MWh	9,530,016 MWh	0.3
Peak load (highest single hourly use)	1,799 MW (January 5, 2004)	1,646 MW (December 30, 2003)	9.3
Average number of residential customers	333,560	330,979	0.8
Annual average residential energy consumption (includes estimated unbilled revenue allocation)	8,852 kWh	8,921 kWh	(0.8)

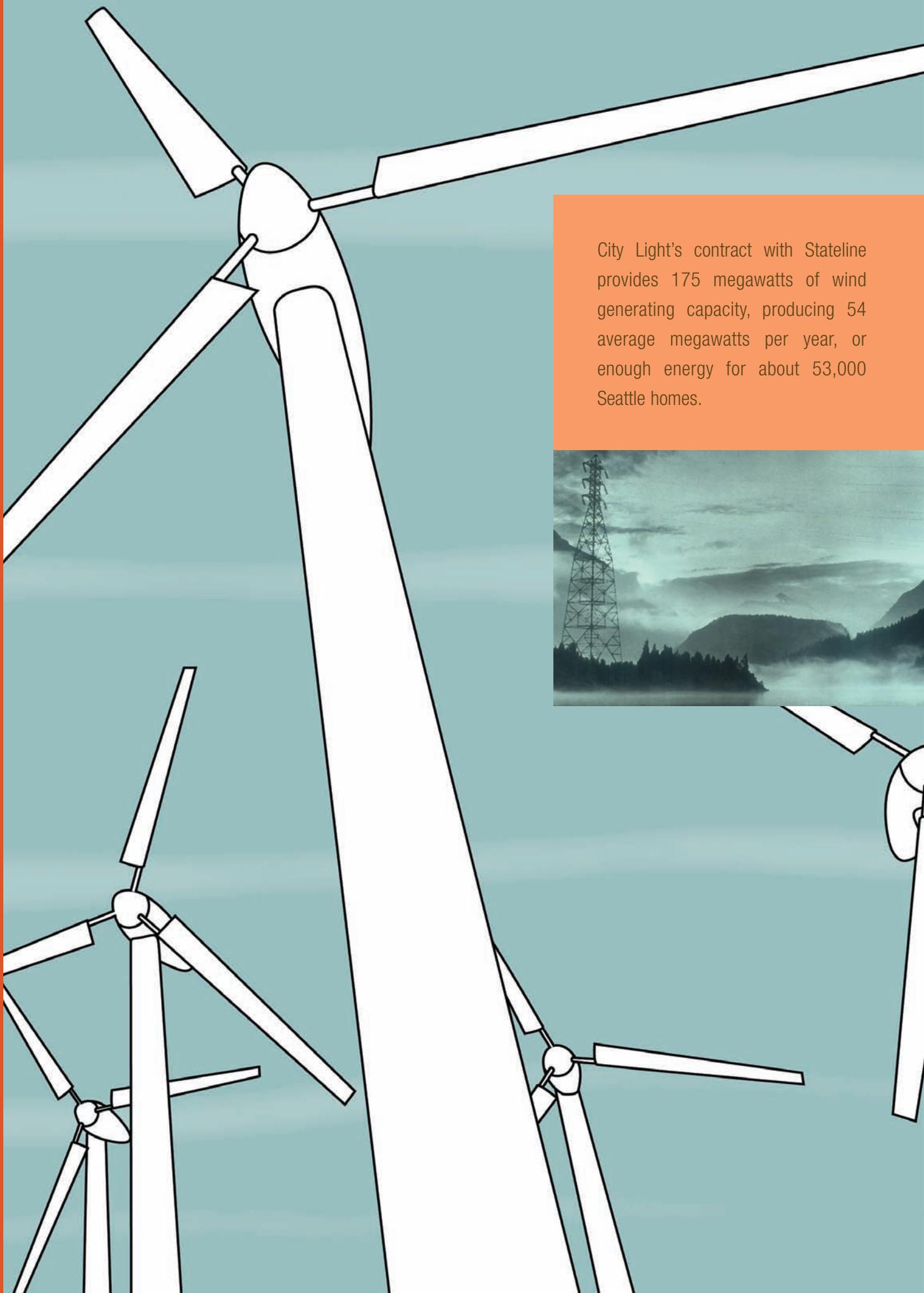
2004 Operating Revenues (in millions = \$777.9)



2004 Operating Expenses (in millions = \$710.0)



City Light's contract with Stateline provides 175 megawatts of wind generating capacity, producing 54 average megawatts per year, or enough energy for about 53,000 Seattle homes.



Resources

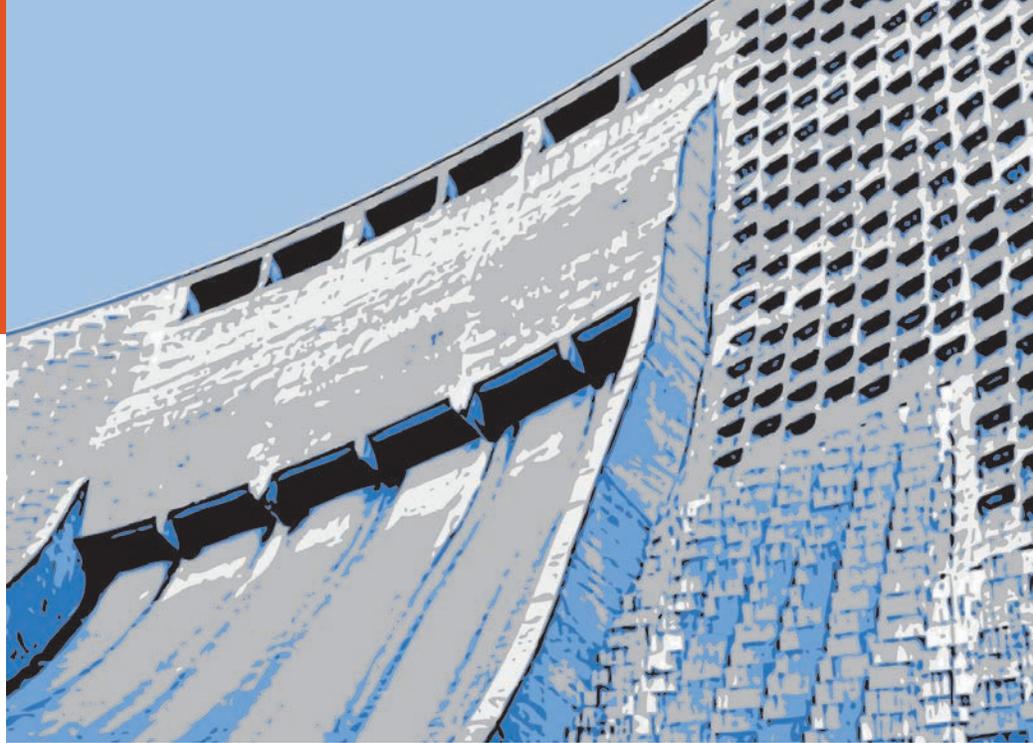
City Light's power portfolio continued to prove its value in 2004, meeting energy demand within the service territory and producing a surplus for the wholesale market, even under poor water conditions. Disregarding power costs that were deferred from 2001, the utility's net power cost delivered was \$19.27 per megawatt-hour in 2004, down from \$20.51 in 2003.

City Light's dams on the Skagit and Pend Oreille rivers produced more than 46 percent of the utility's total power supply. Almost 36 percent came from the Bonneville Power Administration (BPA). The rest came from a variety of other sources, including a gas-fired combustion turbine in Klamath Falls, Ore., and the Stateline Wind Project near Walla Walla, Wash.

In November 2004, City Light assured delivery of energy from Stateline through 2021 when it secured long-term transmission capacity from PacifiCorp at a cost of \$2.3 million. City Light signed a 20-year contract for Stateline wind energy in 2001, but at that time, the utility could only secure transmission rights for 10 years.

City Light's contract with Stateline provides 175 megawatts of wind generating capacity, producing 54 average megawatts per year, or enough energy for about 53,000 Seattle homes.

Under its contract with BPA, City Light currently receives a block shaped to its monthly net requirement of 163.8 average megawatts. It also receives a "slice" of the system, through which the utility purchases 4.6676 percent of the federal



Columbia River system output and pays the same percentage of the system's actual costs. That slice averages 330 megawatts. Monthly payments are based on a projection of system costs, with an annual true-up when actual costs have been determined. In 2004, true-up calculations resulted in net credits to City Light totaling \$4.4 million.

Boundary Relicensing and Integrated Resource Plan

City Light in 2004 embarked on two initiatives with important long-term implications for its resource portfolio: relicensing of the Boundary Hydroelectric Project and an Integrated Resource Plan (IRP).

The Boundary Hydroelectric Project is City Light's largest generating facility, supplying up to 40 percent of Seattle's power requirements. Total plant capability is about 1,051 megawatts at maximum pool elevations. It is a reliable, renewable resource and City Light's most economical source of power. The dam is located in a narrow canyon of the Pend Oreille River, in the northeastern corner of Washington State, 107 miles north of Spokane and one mile south of the Canadian border.

The project's federal license does not expire until 2011, but City Light has already begun the complex and extensive relicensing process. The utility studied three processes administered by the Federal Energy Regulatory Commission (FERC) and determined the Integrated Licensing Process (ILP) would best suit the City of Seattle's needs, because it provides more opportunity for early consultations and stakeholder participation before filing the license application. City Light held an initial public meeting at Boundary in November 2004 and is working with stakeholders representing fish and wildlife agencies, area tribes, environmental organizations and others.

Also in 2004, City Light began work on an Integrated Resource Plan, scheduled to be completed by 2006. The plan will identify a long-term resource strategy to meet customer load at minimum cost, risk and environmental impact. Work in 2004 involved hiring a consultant to review and evaluate City Light's preliminary IRP background work and help identify a preferred approach and scope for the 2006 IRP. Given the current industry environment for electric utilities, City Light expects to incorporate risk management and transmission issues in its IRP.



Environment

City Light received the award for its work to protect salmon in the upper Skagit River, and for its consistent support of Salmon Homecoming objectives through 12 years of service to tribal and nontribal communities.

In 2004, City Light continued to build on its record as one of the cleanest, greenest utilities in the country.

For the sixth consecutive year, the National Hydropower Association (NHA) recognized City Light for outstanding environmental stewardship in the Skagit River watershed. The utility continued to work with stakeholders, preserve and improve salmon habitat, conduct research on bull trout biology, and manage river flows to aid spawning and nesting fish.

Those efforts were also recognized by the Salmon Homecoming Alliance, which awarded City Light the Seventh Generation Legacy Cornerstone Award in September. City Light received the award for its work to protect salmon in the upper Skagit River, and for its consistent support of Salmon Homecoming objectives through 12 years of service to tribal and nontribal communities.

The Seventh Generation Legacy Awards are presented as an acknowledgement of contributions and programs made by individuals and entities that benefit the salmon resource and build tribal/nontribal team spirit in the process. The award's name reflects the tribal tradition of basing today's decisions on the impacts they will have on descendants, seven generations from now.



Conservation

City Light continued its progress in 2004 toward meeting all load growth through 2011 through conservation and new renewable resources.

Through the Conservation Augmentation Agreement with the Bonneville Power Administration, City Light received \$8.63 million in 2004. City Light anticipated a minimum of 7.45 average megawatts of energy savings for federal fiscal year 2003-2004.

Energy savings in the commercial and industrial sectors amounted to 5.92 average megawatts in calendar year 2004. The increase from last year's 4.42 average megawatts reflected a recovering economy and an improving climate for energy-efficiency investments by large businesses. City Light was involved with 227 customer contracts among large companies, institutions and governments within the service territory. City Light's energy management field staff experts provided technical assistance and aggressive new construction and retrofit programs for lighting, heating and cooling systems and industrial processes.

City Light's community conservation programs - aimed at residential customers, multifamily building owners and small businesses - realized 1.5 average megawatts of savings in 2004, slightly below savings of 1.72 average megawatts in 2003. The programs provide financial incentives for multifamily retrofits and new construction, small

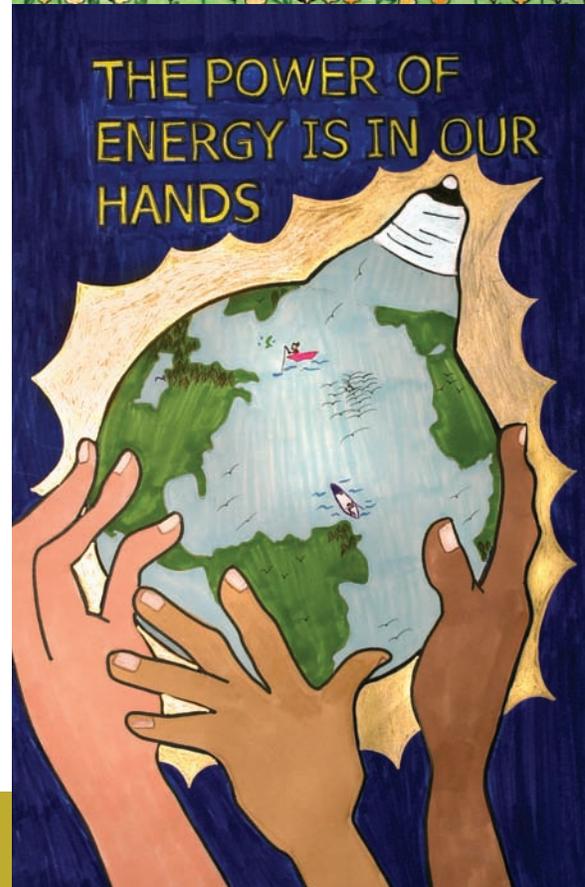
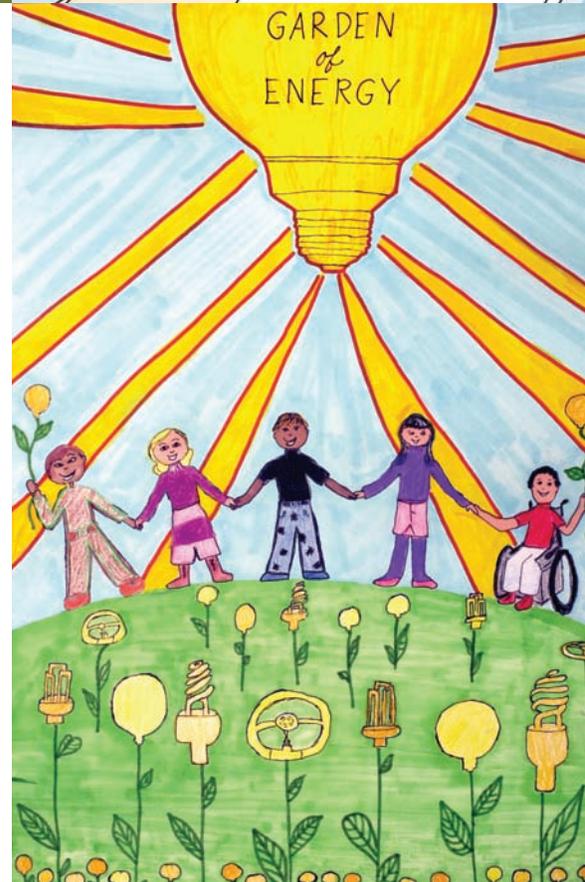
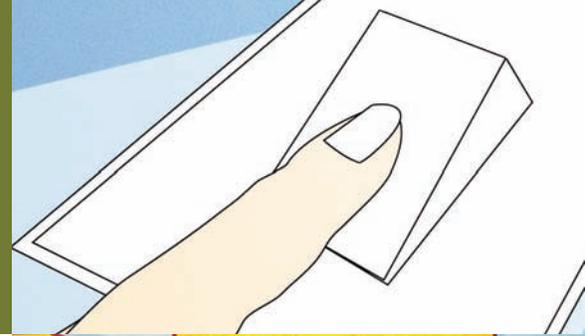
commercial lighting retrofit, resource-efficient clothes washers and low-income residential conservation. In 2004, City Light was involved in 38 new multifamily construction projects, 171 multifamily retrofits and 349 projects with small businesses. The utility provided Wash Wise rebates to 4,551 customers.

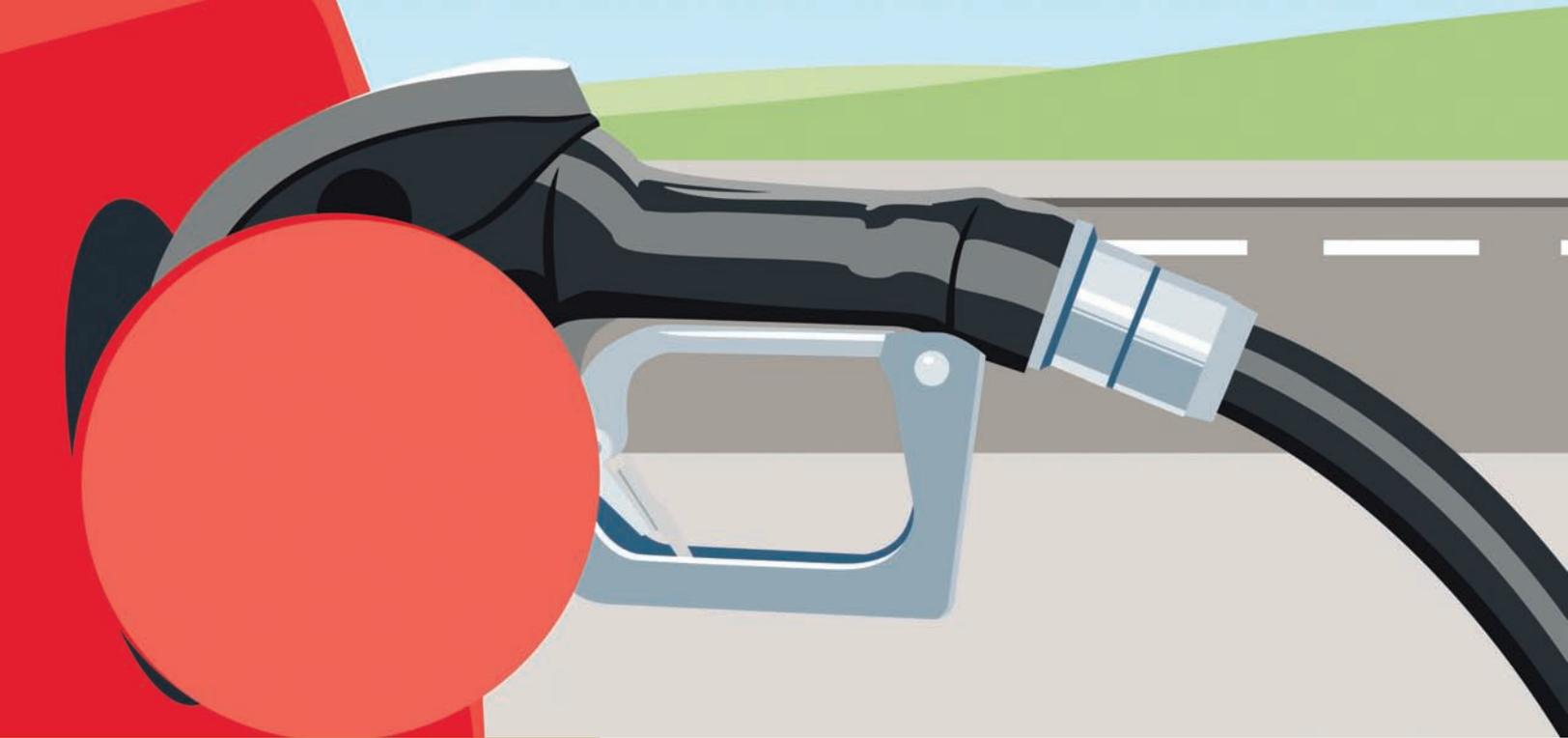
Total 2004 energy savings for all sectors was enough to power 110,000 Seattle homes for one year. The resulting reduction in greenhouse gas emissions is the equivalent of removing 70,600 vehicles from the region's roads for the next 18 years.

The Neighborhood Power Project targets a different neighborhood each year to promote resource conservation. Focusing on Seattle's Ballard and North Rainier/International District neighborhoods in 2004, City Light performed 183 green audits for residential customers and distributed 9,930 compact fluorescent light bulbs to the community.



Garden, Reyn Gross
Hands, LaToya Weber





In 2004, City Light implemented its biodiesel program. Biodiesel is a renewable fuel that can be made from raw or recycled vegetable oils and animal fats.

Greenhouse gas mitigation

To fight global warming, the City of Seattle adopted a Greenhouse Gas Mitigation Strategy for City Light in 2001. It set standards for calculating greenhouse-gas emissions from all City Light resources and operations, as well as strategies for mitigating them. Under the first greenhouse-gas offset contract, signed with Climate Trust in 2003, City Light buys offsets produced by the use of substitute cement materials.

In 2004, City Light implemented its biodiesel program. Biodiesel is a renewable fuel that can be made from raw or recycled vegetable oils and animal fats. It contains almost no sulfur, and using a gallon of biodiesel instead of a gallon of petroleum diesel reduces greenhouse-gas emissions by 78%.

City Light is helping pay for the cost of biodiesel in local bus, garbage truck and ferry fleets. Partnering with large users of petroleum diesel leverages City Light's efforts by helping to build demand for biodiesel. As demand builds, local production will increase, and the price will go down as availability increases. This will encourage more widespread use, producing cleaner air locally and creating economic opportunity in rural communities where vegetable-oil-producing crops are grown.

City Light was also a partner in 2004 in the Shore Power program. The utility agreed to extend electrical distribution lines onto the Port of Seattle's Pier 30 so docked cruise ships could access the City Light system and avoid running diesel or natural gas motors to power their hotel functions while in port.

Through biodiesel, shore power and other mitigation programs, City Light intends to offset the equivalent of 200,000 metric tons of carbon dioxide per year starting in 2005.

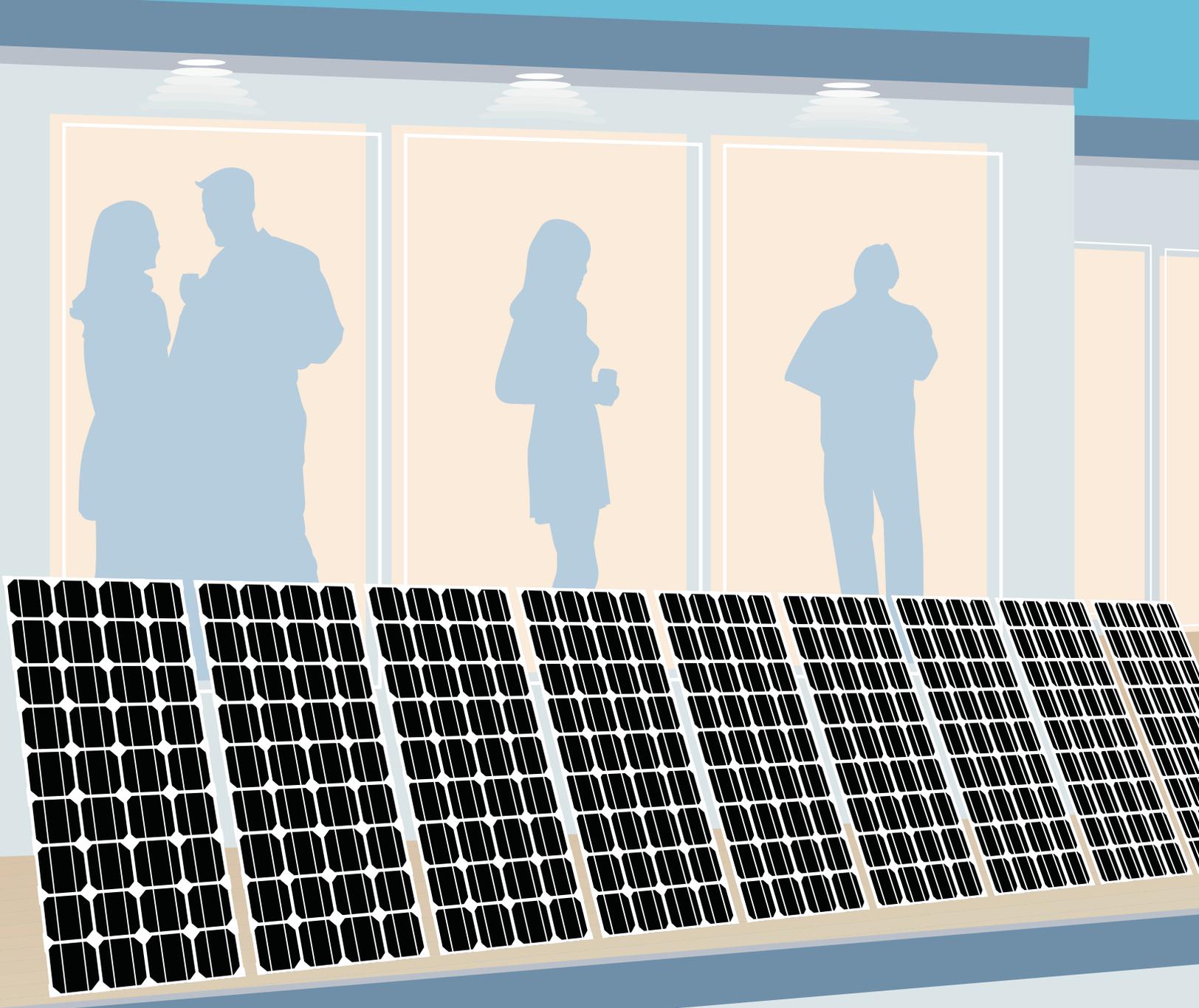
Seattle Green Power

Seattle Green Power gives customers the option to help City Light increase the development of new

sources of renewable energy, including solar projects at local public and non-profit facilities. Under the program, customers make voluntary payments in addition to their regular bills to support clean energy with no greenhouse gas emissions.

Customer contributions to Seattle Green Power support local and regional renewable energy projects, including solar, that are not currently part of City Light's resource portfolio. In 2004 City Light completed seven new public solar demonstration projects, with a capacity rating of 43 kilowatts. Partners included the Seattle Center, the U.S. General Services Administration, the University of Washington, the Seattle Public Library and the Shoreline School District.

City Light partnered with Pioneer Organics to promote Seattle Green Power in 2004. Customers who signed up for green power during the promotion received a free package of fresh organic produce worth \$30. The effort resulted in 1,450 new residential green power subscribers, bringing the total to 4,800 by the end of 2004.





Customer Service

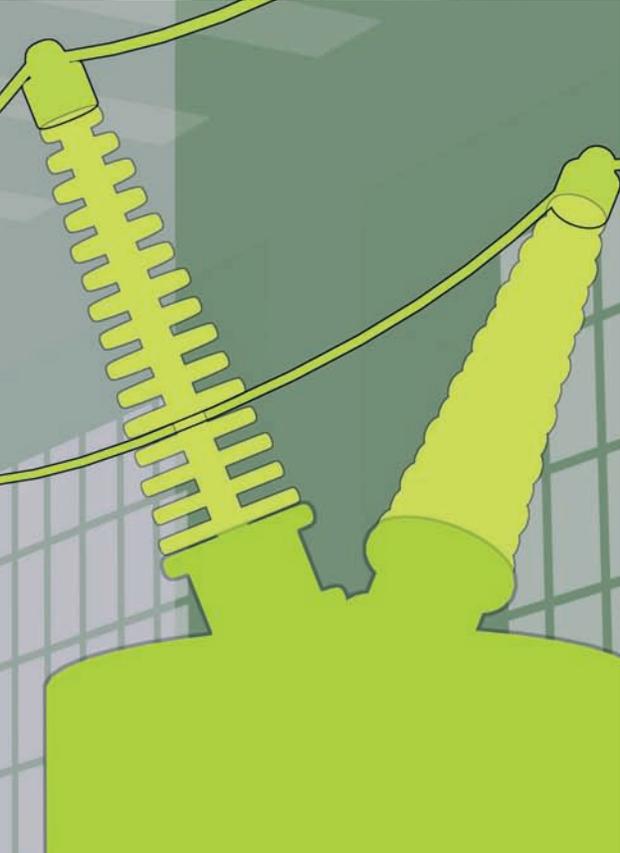
Phase I of City Light's organizational restructuring created four business units. The former customer service and distribution branches were combined into one Customer Service unit. Now all the people who provide the utility's direct service to customers - from billing to meter reading to line repair to conservation programs - are in the same business unit. Customer Service is responsible for 14 substations, 2,000 feeder lines, 3,100 miles of distribution circuit, 370,000 customer billing accounts and 381,000 customer meters.

The year began eventfully for the unit. An early-January storm brought snow and freezing rain to the region, sent trees into power lines and left more than 45,000 City Light customers without power. Line crews worked around the clock in difficult and dangerous conditions to restore power.

On a less dramatic but no less important note, City Light developed and adopted a planning framework for its Transmission and Distribution Capacity Plan, expected to be completed in mid-2005. The frame-

work will guide the utility's plan for meeting system demand over the next 20 years, particularly in growth areas like South Lake Union, South Downtown (SODO), the Denny Triangle and downtown Seattle. The capacity plan will identify substations, feeders and geographic areas that will require new capacity and recommend a range of improvements and solutions.

Major engineering and fieldwork was necessary in 2004 to relocate electrical infrastructure in the path of Sound Transit's LINK light rail project in South Seattle and downtown. City Light's work kept pace with Sound Transit's planning and construction throughout the year. City Light also performed planning and technical work in anticipation of possible replacement of the Alaskan Way Viaduct and construction of the Seattle Monorail.



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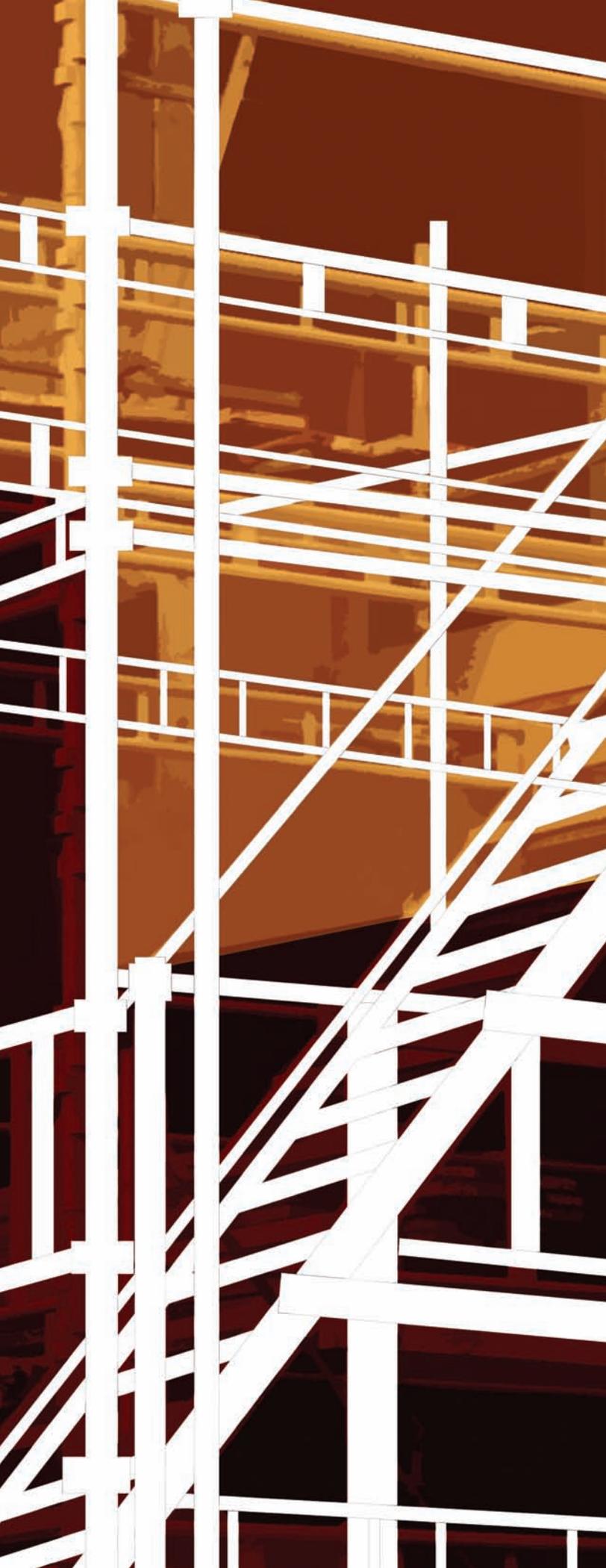


“Change your opinions, keep to your principles;
change your leaves, keep intact your roots.”

Victor Hugo

As City Light undertook to transform itself in 2004, it did so with a firm grasp on its fundamental principles and new nourishment for its deep roots. While undergoing change, the utility continued to embrace the benefits of public power, respect for the environment, and accountability to its citizen owners.

It was truly a watershed year for the utility, with new leadership in place, organizational restructuring begun and crucial financial milestones achieved. 2004 happened to mark the 99th year since City Light began generating power for the citizens of Seattle. As the year ended, the utility was poised to celebrate its past and anticipate its next century of service.



Executive Team

Jorge Carrasco, Superintendent

Steve Call, Interim Chief Financial Officer

Beatrice Hughes, Interim Human Resources Officer

Hardev Juj, Interim Customer Service & Energy Delivery Officer

John Prescott, Power Supply & Environmental Affairs Officer

Bob Royer, Director of Communications and Public Affairs

Elected Officials

Mayor

Greg Nickels

Seattle City Council

Jan Drago, Council President, Chair: Government Affairs & Labor Committee

Jim Compton, Chair: Utilities & Technology Committee

Richard Conlin, Chair: Transportation Committee

David Della, Chair: Parks, Neighborhoods, & Education Committee

Jean Godden, Chair: Energy & Environmental Policy Committee

Nick Licata, Chair: Public Safety, Civil Rights, & Arts Committee

Richard McIver, Chair: Finance & Budget Committee

Tom Rasmussen, Chair: Housing, Human Services, & Health Committee

Peter Steinbrueck, Chair: Urban Development & Planning Committee

City Attorney

Thomas A. Carr

City Light Advisory Board

Donald Wise, Chair

Carol Arnold

Randy Hardy

Jay F. Lapin

Sara Patton

Gary B. Swofford