

Table of Contents

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D. C. 20549
FORM 10-K**

(Mark One)

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended **December 31, 2007**

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from _____ to _____

Commission file number 1-15973

**NW Natural****NORTHWEST NATURAL GAS COMPANY**

(Exact name of registrant as specified in its charter)

Oregon

(State or other jurisdiction of incorporation or organization)

93-0256722

(I.R.S. Employer Identification No.)

220 N.W. Second Avenue, Portland, Oregon 97209

(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code: **(503) 226-4211**

Securities registered pursuant to Section 12(b) of the Act:

Title of each class

Common Stock

Name of each exchange on which registered

New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: None.

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definition of "accelerated filer," "large accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large Accelerated Filer Accelerated Filer Non-accelerated filer Smaller Reporting Company Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

As of June 29, 2007, the registrant had 26,815,203 shares of its Common Stock outstanding. The aggregate market value of these shares of Common Stock (based upon the closing price of these shares on the New York Stock Exchange on that date) held by non-affiliates was \$1,226,580,437.

At February 25, 2008, 26,408,248 shares of the registrant's Common Stock (the only class of Common Stock) were outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

List documents incorporated by reference and the Part of the Form 10-K into which the document is incorporated.

Table of Contents

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Table of Contents

	<u>Page</u>
1. <u>Management's Report on Internal Control Over Financial Reporting</u>	65
2. <u>Report of Independent Registered Public Accounting Firm</u>	66
3. <u>Consolidated Financial Statements:</u>	
<u>Consolidated Statements of Income for the Years Ended December 31, 2007, 2006 and 2005</u>	68
<u>Consolidated Balance Sheets at December 31, 2007 and 2006</u>	69
<u>Consolidated Statements of Shareholders' Equity and Comprehensive Income for the Years Ended December 31, 2007, 2006 and 2005</u>	71
<u>Consolidated Statements of Cash Flows for the Years Ended December 31, 2007, 2006 and 2005</u>	72
<u>Notes to Consolidated Financial Statements</u>	73
4. <u>Quarterly Financial Information (unaudited)</u>	107
5. <u>Supplementary Data for the Years Ended December 31, 2007, 2006 and 2005:</u>	
<u>Financial Statement Schedule</u>	
<u>Schedule II—Valuation and Qualifying Accounts and Reserves</u>	108

Supplemental Schedules Omitted

All other schedules are omitted because of the absence of the conditions under which they are required or because the required information is included elsewhere in the financial statements.

Table of Contents**MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING**

Management is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934, as amended. Our internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles in the United States of America (GAAP). Our internal control over financial reporting includes those policies and procedures that:

(i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions involving company assets;

(ii) provide reasonable assurance that transactions are recorded as necessary to permit the preparation of financial statements in accordance with GAAP, and that receipts and expenditures are being made only in accordance with authorizations of management and the Board of Directors; and

(iii) provide reasonable assurance regarding prevention or timely detection of the unauthorized acquisition, use or disposition of our assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements or fraud. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Management assessed the effectiveness of NW Natural's internal control over financial reporting as of December 31, 2007. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in *Internal Control-Integrated Framework*.

Based on our assessment and those criteria, management has concluded that NW Natural maintained effective internal control over financial reporting as of December 31, 2007.

The effectiveness of internal control over financial reporting as of December 31, 2007 has been audited by PricewaterhouseCoopers LLP, an independent registered public accounting firm, as stated in their report which appears in this annual report.

/s/ Mark S. Dodson
Mark S. Dodson
Chief Executive Officer

/s/ David H. Anderson
David H. Anderson
Senior Vice President and Chief Financial Officer

February 29, 2008

Table of Contents**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the Board of Directors and Shareholders of
Northwest Natural Gas Company:

In our opinion, the consolidated financial statements listed in the accompanying table of contents present fairly, in all material respects, the financial position of Northwest Natural Gas Company and its subsidiaries at December 31, 2007 and 2006, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2007 in conformity with accounting principles generally accepted in the United States of America. In addition, in our opinion, the financial statement schedule listed in the accompanying table of contents presents fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2007, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for these financial statements and the financial statement schedule, for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control Over Financial Reporting. Our responsibility is to express opinions on these financial statements, on the financial statement schedule and on the Company's internal control over financial reporting based on our integrated audits. We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included 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. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

As discussed in Note 1 to the consolidated financial statements, the Company changed the manner in which it accounts for share based compensation in 2006. As discussed in Note 7 to the consolidated financial statements, the Company changed the manner in which it accounts for defined benefit pension and other postretirement plans effective December 31, 2006.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and the board of directors of the company; and

Table of Contents

(iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ PricewaterhouseCoopers LLP
Portland, Oregon
February 29, 2008

Table of Contents

NORTHWEST NATURAL GAS COMPANY
CONSOLIDATED STATEMENTS OF INCOME

Thousands, except per share amounts (year ended December 31)	2007	2006	2005
Operating revenues:			
Gross operating revenues	\$ 1,033,193	\$ 1,013,172	\$ 910,486
Less: Cost of sales	639,150	648,156	563,860
Revenue taxes	25,001	24,840	21,633
Net operating revenues	<u>369,042</u>	<u>340,176</u>	<u>324,993</u>
Operating expenses:			
Operations and maintenance	120,488	114,560	113,216
General taxes	25,288	24,419	23,185
Depreciation and amortization	68,343	64,435	61,645
Total operating expenses	<u>214,119</u>	<u>203,414</u>	<u>198,046</u>
Income from operations	154,923	136,762	126,947
Other income and expense - net	1,445	2,134	1,205
Interest charges - net of amounts capitalized	<u>37,811</u>	<u>39,247</u>	<u>37,283</u>
Income before income taxes	118,557	99,649	90,869
Income tax expense	<u>44,060</u>	<u>36,234</u>	<u>32,720</u>
Net income	<u>\$ 74,497</u>	<u>\$ 63,415</u>	<u>\$ 58,149</u>
Average common shares outstanding:			
Basic	26,821	27,540	27,564
Diluted	26,995	27,657	27,621
Earnings per share of common stock:			
Basic	\$ 2.78	\$ 2.30	\$ 2.11
Diluted	\$ 2.76	\$ 2.29	\$ 2.11

See Notes to Consolidated Financial Statements.

Table of Contents

NORTHWEST NATURAL GAS COMPANY
CONSOLIDATED BALANCE SHEETS

Thousands (December 31)	2007	2006
Assets:		
Plant and property:		
Utility plant	\$2,052,161	\$1,963,498
Less accumulated depreciation	<u>615,533</u>	<u>574,093</u>
Utility plant - net	<u>1,436,628</u>	<u>1,389,405</u>
Non-utility property	67,149	42,652
Less accumulated depreciation and amortization	<u>7,904</u>	<u>6,916</u>
Non-utility property - net	<u>59,245</u>	<u>35,736</u>
Total plant and property	<u>1,495,873</u>	<u>1,425,141</u>
Current assets:		
Cash and cash equivalents	6,107	5,767
Accounts receivable	69,442	82,070
Accrued unbilled revenue	78,004	87,548
Allowance for uncollectible accounts	(2,890)	(3,033)
Regulatory assets	17,598	31,509
Fair value of non-trading derivatives	2,903	5,109
Inventories:		
Gas	71,079	68,576
Materials and supplies	8,865	9,552
Income taxes receivable	122	-
Prepayments and other current assets	<u>25,569</u>	<u>21,695</u>
Total current assets	<u>276,799</u>	<u>308,793</u>
Investments, deferred charges and other assets:		
Regulatory assets	175,938	164,771
Fair value of non-trading derivatives	324	1,448
Other investments	54,070	47,985
Other	<u>11,179</u>	<u>8,718</u>
Total investments, deferred charges and other assets	<u>241,511</u>	<u>222,922</u>
Total assets	<u>\$2,014,183</u>	<u>\$1,956,856</u>

See Notes to Consolidated Financial Statements.

Table of Contents

**NORTHWEST NATURAL GAS COMPANY
CONSOLIDATED BALANCE SHEETS**

Thousands (December 31)	2007	2006
Capitalization and liabilities:		
Capitalization:		
Common stock	\$ 331,595	\$ 371,127
Earnings invested in the business	266,658	230,774
Accumulated other comprehensive income (loss)	(3,502)	(2,356)
Total common stock equity	<u>594,751</u>	<u>599,545</u>
Long-term debt	512,000	517,000
Total capitalization	<u>1,106,751</u>	<u>1,116,545</u>
Current liabilities:		
Notes payable	143,100	100,100
Long-term debt due within one year	5,000	29,500
Accounts payable	119,731	113,579
Taxes accrued	13,259	21,230
Interest accrued	2,827	2,924
Regulatory liabilities	61,326	11,919
Fair value of non-trading derivatives	14,829	38,772
Other current and accrued liabilities	29,794	21,455
Total current liabilities	<u>389,866</u>	<u>339,479</u>
Deferred credits and other liabilities:		
Deferred income taxes and investment tax credits	206,340	210,084
Regulatory liabilities	213,764	202,982
Pension and other postretirement benefit liabilities	41,619	52,690
Fair value of non-trading derivatives	3,758	11,031
Other	52,085	24,045
Total deferred credits and other liabilities	<u>517,566</u>	<u>500,832</u>
Commitments and contingencies (see Note 12)	-	-
Total capitalization and liabilities	<u>\$2,014,183</u>	<u>\$1,956,856</u>

See Notes to Consolidated Financial Statements.

Table of Contents

NORTHWEST NATURAL GAS COMPANY
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY AND
COMPREHENSIVE INCOME

Thousands	Common Stock and Premium	Earnings Invested in the Business	Unearned Stock Compensation	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity	Comprehensive Income
Balance at Dec. 31, 2004	\$387,265	\$ 183,932	\$ (862)	\$ (1,818)	\$ 568,517	
Net Income	-	58,149	-	-	58,149	\$ 58,149
Minimum pension liability adjustment, net of \$59 of tax	-	-	-	(93)	(93)	(93)
Restricted stock amortizations	-	-	212	-	212	
Dividends paid on common stock	-	(36,376)	-	-	(36,376)	
Tax benefits from employee stock option plan	220	-	-	-	220	
Issuance of common stock	7,266	-	-	-	7,266	
Common stock repurchased	(14,945)	-	-	-	(14,945)	
Convertible debentures	3,999	-	-	-	3,999	
Common stock expense	-	(18)	-	-	(18)	
Balance at Dec. 31, 2005	383,805	205,687	(650)	(1,911)	586,931	\$ 58,056
Net Income	-	63,415	-	-	63,415	\$ 63,415
Minimum pension liability adjustment, net of \$52 of tax	-	-	-	(81)	(81)	(81)
Recognition of non-qualified employee benefit plan liability, net of \$232 of tax	-	-	(364)	(364)		
Restricted stock amortizations	298	-	-	-	298	
Dividends paid on common stock	-	(38,298)	-	-	(38,298)	
Tax benefits from employee stock option plan	317	-	-	-	317	
Stock-based compensation	555	-	-	-	555	
Restricted stock reclassification	(650)	-	650	-	-	
Issuance of common stock	2,773	-	-	-	2,773	
Common stock repurchased	(15,971)	-	-	-	(15,971)	
Common stock expense	-	(30)	-	-	(30)	
Balance at Dec. 31, 2006	371,127	230,774	-	(2,356)	599,545	\$ 63,334
Net Income	-	74,497	-	-	74,497	\$ 74,497
Change in unrealized loss from price risk management activities	-	-	-	(41)	(41)	(41)
Change in non-qualified employee benefit plan liability, net of \$487 of tax	-	-	-	(1,232)	(1,232)	(1,232)
Amortization of non-qualified employee benefit plan liability, net of (\$81) of tax	-	-	-	127	127	127
Restricted stock amortizations	285	-	-	-	285	
Dividends paid on common stock	-	(38,613)	-	-	(38,613)	
Tax benefits from employee stock option plan	536	-	-	-	536	
Stock-based compensation	2,094	-	-	-	2,094	
Issuance of common stock	2,180	-	-	-	2,180	
Common stock repurchased	(44,627)	-	-	-	(44,627)	
Balance at Dec. 31, 2007	\$331,595	\$ 266,658	\$ -	\$ (3,502)	\$ 594,751	\$ 73,351

See Notes to Consolidated Financial Statements.

Table of Contents

NORTHWEST NATURAL GAS COMPANY
CONSOLIDATED STATEMENTS OF CASH FLOWS

Thousands (year ended December 31)	2007	2006	2005
Operating activities:			
Net income	\$ 74,497	\$ 63,415	\$ 58,149
Adjustments to reconcile net income to cash provided by operations:			
Depreciation and amortization	68,343	64,435	61,645
Deferred income taxes and investment tax credits	(5,252)	(16,440)	9,551
Undistributed earnings from equity investments	(130)	(191)	(57)
Deferred gas costs - net	38,665	20,752	2,577
Gain on sale of non-utility investments	(1,544)	(495)	-
Income from life insurance investments	(1,939)	(2,609)	(1,873)
Contributions to qualified defined benefit pension plans	-	-	(31,000)
Non-cash expenses related to qualified defined benefit pension plans	4,387	5,500	4,532
Deferred environmental expenditures	(8,842)	(6,675)	(9,132)
Deferred regulatory costs and other	(2,940)	14,533	3,243
Changes in working capital:			
Accounts receivable and accrued unbilled revenue - net	22,029	(3,722)	(40,262)
Inventories of gas, materials and supplies	(1,816)	8,033	(19,684)
Income taxes receivable	(122)	13,234	2,736
Prepayments and other current assets	(6,528)	2,952	(3,439)
Accounts payable	5,841	(21,708)	32,809
Accrued interest and taxes	(8,068)	8,511	2,504
Other current and accrued liabilities	7,059	(959)	6,767
Cash provided by operating activities	<u>183,640</u>	<u>148,566</u>	<u>79,066</u>
Investing activities:			
Investment in utility plant	(93,785)	(95,307)	(89,259)
Investment in non-utility property	(24,442)	(1,773)	(6,842)
Proceeds from sale of non-utility investments	2,628	2,517	3,001
Proceeds from life insurance	881	4,009	296
Contributions to non-utility equity investments	(5,413)	-	-
Other	2,652	(13)	796
Cash used in investing activities	<u>(117,479)</u>	<u>(90,567)</u>	<u>(92,008)</u>
Financing activities:			
Common stock issued, net of expenses	2,180	3,913	7,486
Common stock repurchased	(44,627)	(15,971)	(14,945)
Long-term debt issued	-	25,000	50,000
Long-term debt retired	(29,500)	(8,000)	(15,528)
Change in short-term debt - net	43,000	(26,600)	24,200
Cash dividend payments on common stock	(38,613)	(38,298)	(36,376)
Other	1,739	581	-
Cash (used in) provided by financing activities	<u>(65,821)</u>	<u>(59,375)</u>	<u>14,837</u>
Increase (decrease) in cash and cash equivalents	340	(1,376)	1,895
Cash and cash equivalents - beginning of period	5,767	7,143	5,248
Cash and cash equivalents - end of period	<u>\$ 6,107</u>	<u>\$ 5,767</u>	<u>\$ 7,143</u>
Supplemental disclosure of cash flow information:			
Interest paid	\$ 38,508	\$ 39,294	\$ 36,974
Income taxes paid	\$ 56,215	\$ 31,270	\$ 28,479
Supplemental disclosure of non-cash financing activities:			
Conversions to common stock:			
7-1/4 % Series of Convertible Debentures	\$ -	\$ -	\$ 3,999

See Notes to Consolidated Financial Statements.

Table of Contents**NORTHWEST NATURAL GAS COMPANY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:****Organization and Principles of Consolidation**

The consolidated financial statements include the accounts of Northwest Natural Gas Company (NW Natural), which primarily consist of our regulated gas distribution business and our regulated gas storage business, and other businesses which primarily consist of our wholly-owned subsidiary businesses including NNG Financial Corporation (Financial Corporation) and Gill Ranch Storage, LLC (Gill Ranch), and a joint venture in a natural gas transmission pipeline (See Note 2).

In this report, the term “utility” is used to describe the regulated gas distribution business and the term “non-utility” is used to describe the gas storage business and other non-utility investments and business activities (see Note 2). Intercompany accounts and transactions have been eliminated, except for transactions required by regulatory accounting under Statement of Financial Accounting Standards (SFAS) No. 71, “Accounting for the Effects of Certain Types of Regulation,” not to be eliminated.

Investments in corporate joint ventures and partnerships in which our ownership interest is 50 percent or less and over which we do not exercise control are accounted for by the equity method or the cost method (see Note 9).

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles in the United States of America (GAAP) requires management to make estimates and assumptions that affect reported amounts in the consolidated financial statements and accompanying notes. Actual amounts could differ from those estimates and changes would be reported in future periods. Management believes that the estimates and assumptions used are reasonable.

Industry Regulation

Our principal business is the distribution of natural gas, which is regulated by the Oregon Public Utility Commission (OPUC) and the Washington Utilities and Transportation Commission (WUTC). Accounting records and practices of the regulated business conform to the requirements and uniform system of accounts prescribed by these regulatory authorities in accordance with SFAS No. 71. The utility business segment is authorized by the OPUC and the WUTC to earn a reasonable return on invested capital.

In applying SFAS No. 71, we capitalize or defer certain costs and revenues as regulatory assets and liabilities pursuant to orders of the OPUC or WUTC in general rate case or other deferral proceedings, for example, our purchased gas adjustment (PGA) mechanism, to provide for recovery of revenues or expenses from, or refunds to, utility customers in future periods, including a return or a carrying charge.

Table of Contents

At December 31, 2007 and 2006, the amounts deferred as regulatory assets and liabilities were as follows:

Thousands	Current		Non-Current	
	2007	2006	2007	2006
Regulatory assets:				
Unrealized loss on non-trading derivatives ¹	\$14,788	\$30,798	\$ 3,758	\$ 9,584
Income tax asset	-	-	68,649	67,141
Pension and other postretirement benefit obligations ²	1,912	-	27,152	54,425
Environmental costs - paid ³	-	-	27,956	19,113
Environmental costs - accrued but not yet paid ³	-	-	35,098	8,760
Other ⁴	898	711	13,325	5,748
Total regulatory assets	\$17,598	\$31,509	\$175,938	\$164,771
Regulatory liabilities:				
Gas costs payable ⁵	\$46,153	\$ 737	\$ 6,290	\$ 13,041
Unrealized gain on non-trading derivatives ¹	2,903	-	324	-
Accrued asset removal costs	-	-	204,886	187,422
Other ⁴	12,270	11,182	2,264	2,519
Total regulatory liabilities	\$61,326	\$11,919	\$213,764	\$202,982

¹ An unrealized gain or loss on non-trading derivatives does not earn a rate of return or a carrying charge. These amounts, when realized at settlement, are recoverable through utility rates as part of the PGA mechanism.

² Qualified pension plan and other postretirement costs are approved for regulatory deferral. Such amounts are recoverable in rates, including an interest component, when recognized in net periodic benefit cost (see Note 7).

³ Environmental costs are related to sites that are approved for regulatory deferral. We earn the authorized rate of return as a carrying charge on amounts paid, whereas the amounts accrued but not yet paid do not earn a rate of return or a carrying charge until expended.

⁴ Other primarily consists of deferrals and amortizations under approved regulatory mechanisms. The accounts being amortized typically earn a rate of return or carrying charge.

⁵ A majority of gas costs deferred earn a rate of return or carrying charge.

We believe that continued application of SFAS No. 71 for regulated activities is appropriate and consistent with the current regulatory environment, and that all regulated assets and liabilities at December 31, 2007 and 2006 are recoverable or refundable through future utility rates. We annually review all regulatory assets for recoverability and more often if circumstances warrant. If we should determine that all or a portion of these regulatory assets or liabilities no longer meet the criteria for continued application of SFAS No. 71, then we would be required to write off the net unrecoverable balances against earnings.

New Accounting Standards**Adopted Standards**

Accounting for Uncertainty in Income Taxes. On January 1, 2007, we adopted Financial Accounting Standards Board (FASB) Interpretation No. 48 (FIN 48), "Accounting for Uncertainty in Income Taxes, an Interpretation of FASB Statement No. 109," which provides guidance for the recognition and measurement of a tax position taken or expected to be taken in

Table of Contents

a tax return. As a result of the implementation of FIN 48, we recognized no change in our recorded assets or liabilities for unrecognized income tax benefits. Based on our analysis of all material tax positions taken, management believes the technical merits of these positions are justified and expects that the full amount of the deductions taken and associated tax benefits will be allowed.

FIN 48 requires the evaluation of a tax position as a two-step process. We must determine whether it is more likely than not that a tax position will be sustained upon examination, including the resolution of any related appeals or litigation processes, based on the technical merits of the position. If the tax position meets the "more likely than not" recognition threshold, then the tax benefit is measured and recorded at the largest amount that is greater than 50 percent likely of being realized upon effective settlement. The reassessment of our tax positions in accordance with FIN 48 did not result in any material change to our financial condition, results of operations or cash flows.

FIN 48 prescribes that a company recognize the benefit of a tax position when it is effectively settled. In May 2007, FASB Staff Position (FSP) FIN 48-1, "Definition of Settlement in FASB Interpretation No. 48," was issued to provide guidance on how to determine whether a tax position is effectively settled for the purpose of recognizing previously unrecognized tax benefits. The provisions of FSP FIN 48-1 did not change the conclusions reached during our adoption of FIN 48.

We are subject to U.S. federal income taxes as well as several state and local income taxes. All of our U.S. federal income tax matters audited by the Internal Revenue Service through the 2004 tax year were concluded during 2006 with no material adjustments. Also, substantially all material state and local income tax matters are closed through the 2003 tax year. Based upon our assessment in connection with the adoption of FIN 48, we do not believe there are any tax positions taken that would not be fully sustained upon audit.

We have also assessed the classification of interest and penalties, if any, related to income tax matters. Pursuant to the application of FIN 48, we have made an accounting policy election to treat interest and penalties related to income tax matters, if any, as a component of income tax expense rather than other operating expenses. See Note 8.

Accounting for Certain Hybrid Instruments. In February 2006, the FASB issued SFAS No. 155, "Accounting for Certain Hybrid Instruments," which amended SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," and SFAS No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities," a replacement of FASB Statement No. 125. SFAS No. 155 allows financial instruments that have embedded derivatives to be accounted for as a whole if the holder elects to account for the whole instrument on a fair value basis. SFAS No. 155 is effective for all financial instruments acquired or issued after January 1, 2007. The adoption and implementation of SFAS No. 155 did not have an impact on our financial condition, results of operations or cash flows.

Recent Accounting Pronouncements

Fair Value Measurements. In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements," which provides a common definition for the measurement of fair value for use

Table of Contents

in applying GAAP and in preparing financial statement disclosures. Most of SFAS No. 157 is effective as of the beginning of the first annual period after November 15, 2007, or January 1, 2008. However, implementation of the fair value measurement of liabilities applicable to us has been delayed until the beginning of the first annual period after November 15, 2008. This pronouncement replaces the definition of price used to determine fair value as the "price that would be received to sell an asset or paid to transfer a liability in an orderly transaction." To increase consistency and comparability, it also establishes a hierarchy of inputs used to calculate fair value, ranging from level one (observable) to level three inputs (unobservable).

New disclosures under SFAS No. 157 will primarily consist of:

- A description of the fair value measurements at the reporting date;
- A description of the inputs for fair value calculations;
- A description of the level of each input within the fair value hierarchy, segregated by input level;
- A tabular reconciliation for all level three inputs illustrating the total gains and losses, purchases or sales, and transfers into or out of level three;
- A tabular detail of the gains and losses for the period; and,
- A description of the valuation techniques used to measure fair value and a discussion of changes in valuation techniques, if any.

Adoption of SFAS No. 157 will require us to identify the inputs for our fair value calculations according to the fair value hierarchy, increase coordination with our external service providers and provide more detailed disclosure. Based on our preliminary assessment, the adoption of SFAS No. 157 is not expected to have a material effect on our financial condition, results of operations or cash flow.

Fair Value Option for Financial Assets and Liabilities. In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities," which permits entities to choose to measure many financial instruments and certain other items at fair value. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007. Based on our preliminary evaluation, the adoption and implementation of SFAS No. 159 is not expected to have a material effect on our financial condition, results of operations or cash flow.

Accounting for Income Tax Benefits of Dividends on Share-Based Payment Awards. In November 2006, the Emerging Issues Task Force (EITF) issued EITF 06-11, "Accounting for Income Tax Benefits of Dividends on Share-Based Payment Awards," which provides the accounting requirements for the income tax benefit received on dividends that are paid to employees holding equity-classified nonvested shares, equity-classified nonvested share units or equity-classified outstanding share options, and how these benefits are charged to retained earnings under SFAS No. 123R, "Share Based Payment." EITF 06-11 is effective as of the beginning of the first annual period starting after December 15, 2007.

EITF 06-11 will require us to adjust our current accounting policy on the recognition of the income tax benefit received on dividends paid to employees. Based on our preliminary evaluation, the adoption of EITF 06-11 is not expected to have a material impact on our financial condition, results of operations or cash flow.

Table of Contents

Plant and Property and Accrued Asset Removal Costs

Plant and property is stated at cost, including capitalized labor, materials and overhead (see Note 9). The cost of constructing utility plant and gas storage assets includes an allowance for funds used during construction (AFUDC), which represents the net financing cost during the period the funds are used for construction purposes (see "Allowance for Funds Used During Construction," below).

Our provision for depreciation of utility property is computed under the straight-line, age-life method in accordance with independent engineering studies and as approved by regulatory authorities. The weighted average depreciation rate for utility plant in service was approximately 3.4 percent for each of the years ended December 31, 2007, 2006 and 2005, reflecting the approximate average economic life of the property.

In accordance with long-standing industry practice, we accrue for future asset removal costs on many long-lived assets through a charge to depreciation expense allowed in rates and accumulate such amounts in regulatory liabilities. At the time removal costs are incurred, accumulated depreciation is charged with the costs of removal and the book cost of the asset. Our estimate of accumulated removal costs is based on rates using our most recent depreciation study. No gain or loss is recognized upon normal retirement. In the rate setting process, the accrued asset removal costs are treated as a reduction to the net rate base.

Allowance for Funds Used During Construction

Certain additions to utility plant include AFUDC, which represents the net cost of borrowed or other funds used during construction and is calculated using actual current interest rates. If borrowings are less than the total costs of construction work in progress, then a composite rate of interest on all debt, shown as a reduction to interest charges, and a return on equity funds, shown as other income, is used to compute the AFUDC. While cash is not realized currently from AFUDC, it is realized in future years through increased revenues from rate recovery resulting from higher rate base and higher depreciation expense. Our composite AFUDC rates were 5.4 percent in 2007, 4.7 percent in 2006 and 3.1 percent in 2005.

Cash and Cash Equivalents

For purposes of reporting cash flows, cash and cash equivalents include cash on hand and highly liquid temporary investments with original maturity dates of three months or less. At December 31, 2007 and 2006, book overdrafts of \$4.9 million and \$3.7 million, respectively, were included within accounts payable.

Revenue Recognition and Accrued Unbilled Revenues

Utility revenues, derived primarily from the sale and transportation of gas, are recognized when the gas is delivered to and received by the customer. Revenues include accruals for gas delivered but not yet billed to customers based on estimates of gas deliveries from meter reading dates to month end (accrued unbilled revenues). Accrued unbilled revenues are dependent upon a number of factors that require management's judgment, including total gas receipts and deliveries, customer use and weather. Accrued unbilled revenues are reversed the

Table of Contents

following month when actual billings occur. Our accrued unbilled revenues at December 31, 2007 and 2006 were \$78.0 million and \$87.5 million, respectively.

Utility revenues may also include the recognition of a regulatory adjustment for income taxes paid. This revenue adjustment reflects an OPUC rule whereby we are required to implement a rate refund or a rate surcharge to utility customers. This automatic refund or surcharge is accrued based on the estimated difference between income taxes paid and income taxes authorized to be collected in rates for the tax year.

Non-utility revenues, derived primarily from gas storage services, are recognized upon delivery of the service to customers. Revenues from optimization of excess storage and transportation capacity include amounts that are recognized ratably over the life of the contract for guaranteed amounts, or as earned for amounts above the guaranteed amount based on the terms of our contract with the independent energy marketing company which optimizes the value of our assets primarily through the use of commodity transactions and capacity release transactions. See Note 2.

Accounts Receivable and Allowance for Uncollectible Accounts

Accounts receivable consist primarily of amounts due for gas sales and transportation services to core utility customers, plus amounts due for gas storage and other miscellaneous receivables. With respect to these trade receivables, including accrued unbilled revenues, we establish an allowance for uncollectible accounts (allowance) based on the aging of receivables, collection experience of past due accounts on payment plans, and historical trends of write-offs as a percent of revenues. With respect to large individual customer receivables, a specific allowance is established and added to the general allowance when amounts are identified as unlikely to be partially or fully recovered. Inactive accounts are written-off against the allowance after they are 120 days past due or when deemed to be uncollectible. Differences between our estimated allowance and actual write-offs will occur based on changes in general economic conditions, customer credit issues and the level of natural gas prices. Each quarter the allowance for the uncollectible accounts is adjusted, if necessary, based on the most current information available.

Inventories

Inventories, which consist primarily of natural gas in storage for the utility, are generally stated at the lower of average cost or net realizable value. The regulatory treatment of gas inventories provides for full cost recovery in customer rates, subject to a prudence review, including any differences between the actual purchase cost of gas injected into inventory and the embedded cost of inventory in current rates. All gas that is injected into storage is priced into inventory at the actual purchase cost based on a regulatory dispatch model for our gas purchases. All gas that is withdrawn from inventory is charged to cost of gas during the current period at the weighted average cost of inventory embedded in customer rates, which is established in our annual PGA filing. Material and supplies inventories are stated at the lower of average cost or net realizable value.

Table of Contents

Derivatives

In accordance with SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," as amended by SFAS No. 138, "Accounting for Certain Derivative Instruments and Certain Hedging Activities," and SFAS No. 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities" (collectively referred to as SFAS No. 133), we measure derivatives at fair value and recognize them as either assets or liabilities on the balance sheet. SFAS No. 133 requires that changes in the fair value of a derivative be recognized currently in earnings unless specific hedge accounting criteria are met. SFAS No. 133 provides an exception for contracts intended for normal purchases and normal sales for which physical delivery is probable. In addition, certain derivatives contracts are approved by regulatory authorities for recovery or refund through customer rates. Accordingly, the changes in fair value of these contracts are deferred as regulatory assets or liabilities pursuant to SFAS No. 71. Derivatives contracts entered into for core utility customer requirements after the PGA rate has been set are subject to the PGA incentive sharing mechanism, whereby 67 percent of the changes in fair value are deferred as regulatory assets or liabilities and the remaining 33 percent is recorded to the income statement for derivatives that do not qualify for hedge accounting, and to Other Comprehensive Income for hedges that do qualify for hedge accounting (see Note 11).

Our Financial Derivatives Policy sets forth the guidelines for using selected financial derivative products to support prudent risk management strategies within designated parameters. Our objective for using derivatives is to decrease the volatility of earnings and cash flows and to prevent speculative risk. The use of derivatives is permitted only after the risk exposures have been identified, are determined to exceed acceptable tolerance levels and are considered to be unavoidable because they are necessary to support normal business activities. We do not enter into derivative instruments for trading purposes and we believe that any increase in market risk created by holding derivatives should be offset by the exposures they modify.

Revenue Taxes

We account for taxes assessed by governmental entities as a separate cost collected from customers for remittance to those governmental entities. Therefore, revenue taxes are accounted for as a cost of sale and presented separately on the income statement.

Income Tax Expense

NW Natural and its wholly-owned subsidiaries file consolidated federal and state income tax returns. Current income taxes are allocated based on each entity's respective taxable income or loss and investment tax credits as if each entity filed a separate return. We account for income taxes in accordance with SFAS No. 109, "Accounting for Income Taxes." SFAS No. 109 requires recognition of deferred tax liabilities and assets for the future tax consequences of events that have been included in the consolidated financial statements or tax returns. Under this method, deferred tax liabilities and assets are determined based on the difference between the financial statement and tax basis of assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to reverse (see Note 8).

SFAS No. 109 also requires recognition of deferred income tax assets and liabilities for temporary differences where regulators prohibit deferred income tax treatment for ratemaking

Table of Contents

purposes. We have recorded a deferred tax liability equivalent to \$68.6 million and \$67.1 million at December 31, 2007 and 2006, respectively, to recognize future taxes payable resulting from transactions that have previously been reflected in the financial statements for these temporary differences. Regulatory assets or liabilities corresponding to such additional deferred income tax assets or liabilities may be recorded to the extent we believe they will be recoverable from or payable to customers through the ratemaking process. Pursuant to SFAS No. 71, a corresponding regulatory asset has been recorded which represents the probable future revenue that will result from inclusion in rates charged to customers of taxes which will be paid in the future. The probable future revenue to be recorded takes into consideration the additional future taxes which will be generated by that revenue. Amounts applicable to income taxes due from customers primarily represent differences between the book and tax basis of net utility plant in service and actual removal costs incurred.

Deferred investment tax credits on utility plant additions and leveraged leases, which reduce income taxes payable, are deferred for financial statement purposes and amortized over the life of the related plant or lease. Investment and energy tax credits generated by Financial Corporation are amortized over a period of one to five years.

Other Income and Expense—Net

Other income and expense – net consists of interest income, gain on sale of investments, investment income of Financial Corporation, investment expenses of our proposed pipeline project and other miscellaneous income from merchandise sales, rents, leases and other items.

Thousands	2007	2006	2005
Gains from company-owned life insurance	\$ 1,939	\$2,609	\$ 1,856
Interest income	537	363	403
Earnings from equity investments of Financial Corporation	130	191	57
Gain on sale from equity investments	1,544	-	-
Other non-operating expenses	(2,789)	(852)	(1,393)
Net interest on certain deferred regulatory accounts	84	(177)	282
	<u>\$ 1,445</u>	<u>\$2,134</u>	<u>\$ 1,205</u>

Earnings Per Share

Basic earnings per share are computed using the weighted average number of common shares outstanding each year. Diluted earnings per share reflect the potential effects of the exercise of stock options and other stock-based compensation. Diluted earnings per share are calculated as follows:

Thousands, except per share amounts	2007	2006	2005
Net income	\$74,497	\$63,415	\$58,149
Average common shares outstanding - basic	26,821	27,540	27,564
Stock based compensation	174	117	57
Average common shares outstanding - diluted	<u>26,995</u>	<u>27,657</u>	<u>27,621</u>
Earnings per share of common stock - basic	<u>\$ 2.78</u>	<u>\$ 2.30</u>	<u>\$ 2.11</u>
Earnings per share of common stock - diluted	<u>\$ 2.76</u>	<u>\$ 2.29</u>	<u>\$ 2.11</u>

Table of Contents

For the years ended December 31, 2007, 2006 and 2005, 442 shares, 105,600 shares and 6,000 shares, respectively, represent the number of stock options which were excluded from the calculation of diluted earnings per share because the effect was antidilutive.

Stock-Based Compensation

We periodically provide stock-based compensation to employees in the form of stock options and other incentive awards. As required by SFAS No. 123R, "Share Based Compensation," we recognize the fair value of all share-based payments as compensation expense in the financial statements. Prior to January 1, 2006, as permitted by SFAS No. 123, we applied APB Opinion No. 25, "Accounting for Stock Issued to Employees," to account for stock-based compensation. Accordingly, prior to January 1, 2006, we did not recognize compensation expense for the fair value of our stock option grants. We implemented SFAS 123R effective January 1, 2006 by applying the modified prospective transition method. The impact on net income of this new standard, had it been adopted in 2005, is reflected in the pro forma amounts in Note 4.

2. CONSOLIDATED SUBSIDIARY OPERATIONS AND SEGMENT INFORMATION:

At December 31, 2007, we had two direct wholly-owned subsidiaries, Financial Corporation and Gill Ranch Storage, LLC.

Our core business segment is the local gas distribution segment, also referred to as the "utility," which involves the distribution and sale of natural gas. Another business segment, "gas storage," represents natural gas storage services provided to intrastate and interstate customers, and includes asset optimization services under a contract with an independent energy marketing company. The remaining business segment, "other," primarily consists of wholly-owned subsidiaries, Financial Corporation and Gill Ranch, as well as various other non-utility investments, including an investment in a leveraged aircraft lease and our equity investment in a proposed natural gas pipeline project with TransCanada Gas Transmission Northwest (GTN). See Note 9.

Gas Storage

The gas storage business segment is primarily made up of underground natural gas storage services that we provide to large intra- and inter-state customers using our owned storage capacity at Mist that has been developed in advance of core utility customers' requirements. In Oregon, we retain 80 percent of the income before tax from these services and credit the remaining 20 percent to a deferred regulatory account for sharing with core utility customers. For each of the years ended December 31, 2007, 2006 and 2005, this business segment derived a majority of its revenues from multi-year contracts with less than 10 customers. The largest of these customers is served under a long-term contract.

Results for the gas storage segment include revenues, net of amounts shared with core utility customers, from a contract with an independent energy marketing company that optimizes the use of our assets primarily through the use of commodity transactions and transportation capacity release transactions. In Oregon, we retain 80 percent of the pre-tax income when the costs of the capacity have not been included in utility rates, or 33 percent of the pre-tax income when the costs have been included in core utility rates. The remaining 20 percent and 67 percent, respectively, are credited to a deferred regulatory account for distribution to core utility customers. We have a similar sharing mechanism in Washington for revenue derived from storage and third party optimization.

Table of Contents**Other**

In October 2007, Financial Corporation sold its investments in two wind power electric generating projects for \$2.1 million, which resulted in an after-tax net gain on sale of \$0.9 million. In addition, in December 2007, one low-income housing project investment reached the end of the contract period and our partnership interest was transferred pursuant to the original terms of the agreement.

Financial Corporation holds certain non-utility financial investments, but its assets primarily consist of an active, wholly-owned subsidiary which owns a 10 percent interest in an 18-mile interstate natural gas pipeline. Our capacity on this pipeline is contracted to NW Natural's utility operations. Financial Corporation's remaining assets totaled \$1.4 million and \$2.6 million at December 31, 2007 and 2006, respectively.

At December 31, 2006, we reclassified to current assets our net investment of \$5.3 million in a Boeing 737-300 airplane leased to Continental Airlines. The original lease term expired in September 2007, and the aircraft lease was extended at the option of the lessee for 12 months. We are currently in negotiations to sell the airplane and expect it to be sold during 2008.

Segment Information Summary

The following table presents summary financial information about the reportable segments for 2007, 2006 and 2005. Inter-segment transactions are insignificant.

Thousands	Utility	Gas Storage	Other	Total
<u>2007</u>				
Net operating revenues	\$ 351,875	\$ 16,999	\$ 168	\$ 369,042
Depreciation and amortization	67,410	933	-	68,343
Income (loss) from operations	140,434	14,953	(464)	154,923
Income from financial investments	1,939	-	1,674	3,613
Net income	64,938	8,742	817	74,497
Total assets at Dec. 31, 2007	1,940,844	59,427	13,912	2,014,183
<u>2006</u>				
Net operating revenues	\$ 327,267	\$ 12,761	\$ 148	\$ 340,176
Depreciation and amortization	63,552	883	-	64,435
Income from operations	126,366	9,870	526	136,762
Income from financial investments	2,609	-	191	2,800
Net income	56,653	5,982	780	63,415
Total assets at Dec. 31, 2006	1,912,021	35,970	8,865	1,956,856
<u>2005</u>				
Net operating revenues	\$ 315,248	\$ 9,609	\$ 136	\$ 324,993
Depreciation and amortization	60,935	710	-	61,645
Income (loss) from operations	118,794	8,158	(5)	126,947
Income from financial investments	1,856	-	57	1,913
Net income	52,759	4,557	833	58,149

Table of Contents3. CAPITAL STOCK:Common Stock

As of December 31, 2006 and 2007, we had 60,000,000 common shares authorized.

At December 31, 2007, we had reserved 223,033 shares of common stock for issuance under the Employee Stock Purchase Plan, 666,537 shares under our Dividend Reinvestment and Direct Stock Purchase Plan and 1,393,150 shares under our Restated Stock Option Plan (see Note 4).

In connection with the restatement of our Restated Articles of Incorporation, effective May 31, 2006, the par value of our common stock was eliminated. As a result, at December 31, 2007 and 2006, our "common stock" and "premium on common stock" account balances are reflected on the balance sheet as "common stock."

Stock Repurchase Program

Our publicly announced stock repurchase program allows us to purchase up to 2.8 million shares, or up to \$100.0 million in total, of our common stock in the open market or through privately negotiated transactions. We repurchased a total of 963,428, 395,500 and 410,200, shares under this program in 2007, 2006, and 2005, respectively. In addition, during the first half of 2007, we completed our voluntary oddlot share buyback program, which resulted in a net repurchase of 10,188 shares.

Restated Stock Option Plan

There are 2,400,000 shares authorized for option grants under the Restated Stock Option Plan. At December 31, 2007, options on 1,035,400 shares were available for grant and options on 357,750 shares were outstanding.

Convertible Debentures

In August 2005, we redeemed all of our outstanding Convertible Debentures, 7-1/4% Series due 2012, at 100 percent of their principal amount plus accrued interest to the date of redemption. During 2005, debentures with an aggregate principal amount of \$4.0 million were converted into shares of common stock on or prior to the redemption date at the rate of 50.25 shares for each \$1,000 principal amount of debentures and \$0.5 million of debentures were redeemed.

Table of Contents**Summary of Changes in Common Stock**

The following table shows the changes in the number of shares of our common stock issued and outstanding and the premium on common stock for the years 2007, 2006 and 2005:

	Shares	Premium on common stock (thousands)
Balance, Dec. 31, 2004	27,546,720	\$ 300,034
Sales to employees	30,896	741
Sales to stockholders	113,925	3,741
Exercise of stock options - net	97,068	2,241
Conversion of convertible debentures to common	200,887	3,360
Repurchase	<u>(410,200)</u>	<u>(13,646)</u>
Balance, Dec. 31, 2005	27,579,296	\$ 296,471
Sales to employees	31,397	-
Exercise of stock options - net	68,548	285
Repurchase	(395,500)	(1,461)
Change to no-par common stock	-	<u>(295,295)</u>
Balance, Dec. 31, 2006	27,283,741	\$ -
Sales to employees	21,373	n/a
Exercise of stock options - net	75,850	n/a
Repurchase	<u>(973,616)</u>	<u>n/a</u>
Balance, Dec. 31, 2007	<u>26,407,348</u>	<u>\$ -</u>

4. STOCK-BASED COMPENSATION:

We have the following stock-based compensation plans: the Long-Term Incentive Plan (LTIP); the Restated Stock Option Plan (Restated SOP); the Employee Stock Purchase Plan (ESPP); and the Non-Employee Directors Stock Compensation Plan (NEDSCP). These plans are designed to promote stock ownership in NW Natural by employees and officers and, in the case of the NEDSCP, by non-employee directors.

Long-Term Incentive Plan. The LTIP is intended to provide a flexible, competitive compensation program for eligible officers and key employees. An aggregate of 500,000 shares of common stock was authorized for grants under the LTIP as stock bonus, restricted stock or performance-based stock awards. Shares awarded under the LTIP are purchased on the open market.

At December 31, 2007, 299,721 shares of common stock were available for award under the LTIP, assuming that outstanding performance based grants are awarded at the target level. The LTIP stock awards are compensatory awards for which compensation expense is recognized based on the market value of performance shares earned, or a pro rata amortization over the vesting period for the outstanding restricted stock awards.

Performance-based Stock Awards. Since the LTIP's inception in 2001 through December 31, 2007, performance-based stock awards have been granted annually based on three-year performance periods. At December 31, 2007, certain performance-based stock award

Table of Contents

measures had been achieved for the 2005-07 award period. Accordingly, participants are estimated to receive 66,666 shares of common stock and a dividend equivalent cash payment equal to the number of shares of common stock received on the award payout multiplied by the aggregate cash dividends paid per share during the performance period. At December 31, 2006, certain performance-based stock award measures had been achieved for the 2004-06 award period and participants received 40,446 shares of common stock plus the applicable dividend equivalent cash payment, resulting in \$0.8 million in cash for taxes or deferral into the deferred compensation plan. During 2007, we accrued and expensed \$0.6 million related to the 2005-07 performance-based stock award, and on a cumulative basis we accrued a total \$2.0 million related to the 2005-07 performance period. In 2006, we accrued and expensed \$0.9 million related to the 2004-06 performance-based stock award, and on a cumulative basis we accrued a total of \$1.7 million related to the 2004-06 performance period.

At December 31, 2007, the aggregate number of performance-based shares granted and outstanding at the threshold, target and maximum levels were as follows:

<u>Year Awarded</u>	<u>Performance Period</u>	<u>Performance Share Awards Outstanding</u>		
		<u>Threshold</u>	<u>Target</u>	<u>Maximum</u>
2006	2006-08	7,536	39,665	79,330
2007	2007-09	7,980	42,000	84,000
	Total	15,516	81,665	163,330

The threshold level estimates future payout assuming the minimum award payable other than no payout for each component of the formula in the LTIP. For each of these performance periods, awards will be based on total shareholder return relative to a peer group of gas distribution companies over the three-year performance period and on performance results achieved relative to specific core and non-core strategies. Compensation expense is recognized in accordance with SFAS No. 123R, based on performance levels achieved and an estimated fair value using a Black-Scholes or binomial model. The weighted-average per share grant date fair value of unvested shares at December 31, 2007 and 2006 was \$25.45 and \$30.65, respectively. The weighted-average per share grant date fair value of shares vested during the year was \$44.95 and granted during the year was \$31.32. In 2007, under these LTIP grants we accrued \$2.7 million and expensed \$2.3 million as compensation, while in 2006, we accrued and expensed \$1.0 million.

Restricted Stock Awards. Restricted stock awards also have been granted under the LTIP. A restricted stock award was granted in 2004 consisting of 5,000 shares that will vest ratably over the period 2005-09, and a restricted stock award was granted in 2006 consisting of 6,500 shares that will vest ratably over the period 2007-09. A total of 5,167 restricted stock award shares were vested at December 31, 2007. Compensation expense is recognized ratably over the vesting period.

Restated Stock Option Plan. The Restated SOP authorizes an aggregate of 2,400,000 shares of common stock for issuance as incentive or non-statutory stock options. These options may be granted only to officers and key employees designated by a committee of our Board of Directors. All options are granted at an option price not less than the market value on the date of grant and may be exercised for a period not exceeding 10 years from the date of grant.

Table of Contents

Option holders may exchange shares they have owned for at least six months, at the current market price, to purchase shares at the option price. We use original issue shares upon exercise of options under the plan. See Note 3.

Employee Stock Purchase Plan. The ESPP allows employees to purchase common stock at 85 percent of the closing price on the trading day immediately preceding the initial offering date, which is set annually. Each eligible employee may purchase up to \$24,000 worth of stock through payroll deductions over a six- to 12-month period. We use original issue shares upon exercise of options under the plan. See Note 3.

In accordance with APB Opinion No. 25, no compensation expense was recognized for options granted under the Restated SOP or shares issued under the ESPP during 2005 or earlier years. If compensation expense for awards under these two plans had been determined based on fair value at the grant dates using the method prescribed by SFAS No. 123R, net income and earnings per share would have been reduced to the pro forma amounts shown below:

Pro Forma Effect of Stock-Based Options and ESPP:

Thousands, except per share amounts	2005
Net income as reported	\$58,149
Add: Stock-based compensation expense included in reported net income - net of related tax effects	613
Deduct: Pro forma stock-based compensation expense determined under the fair value based method - net of related tax effects	(940)
Pro forma earnings applicable to common stock	<u>\$57,822</u>
Basic earnings per share	
As reported	\$ 2.11
Pro forma	<u>\$ 2.10</u>
Diluted earnings per share	
As reported	\$ 2.11
Pro forma	<u>\$ 2.09</u>

The fair value of each stock option is estimated on the grant date using the Black-Scholes option pricing model with the following weighted average assumptions and outcomes:

	2007	2006	2005
Risk-free interest rate	4.7%	4.5%	4.2%
Expected life (in years)	6.2	6.2	7.0
Expected market price volatility factor	17.2%	22.8%	24.6%
Expected dividend yield	3.2%	4.0%	3.6%
Forfeiture rate	4%	3%	n/a
Weighted average grant date fair value	\$7.66	\$6.29	\$7.85
Present value of options granted	\$33.38	\$26.00	\$27.87

The simplified formula for "plain vanilla" options was utilized to determine the expected life as defined and permitted by Staff Accounting Bulletin No. 107. The risk-free interest rate was based on the implied yield currently available on U.S. Treasury zero-coupon issues with a life equal to the expected life of the options. Historical data was employed in order to estimate the

Table of Contents

volatility factor, measured on a daily basis, for a period equal to the duration of the expected life of the option awards. The dividend yield was based on management's current estimate for dividend payout at the time of grant. We expense the total cost of stock option awards granted to retirement eligible employees at the date of grant in accordance with SFAS No. 123R and the retirement vesting provisions of our option agreements.

Information regarding the Restated SOP's activity for the three years ended December 31, 2007 is summarized as follows:

	Option Shares	Price per Share		Intrinsic Value (In millions)
		Range	Weighted - Average Exercise Price	
Balance outstanding, Dec. 31, 2004	431,470	\$20.25 - 32.02	\$ 28.38	n/a
Granted	9,000	34.95 - 38.30	37.18	n/a
Exercised	(121,170)	20.25 - 31.34	26.59	\$ 1.2
Forfeited	(10,800)	27.60 - 31.34	30.79	n/a
Balance outstanding, Dec. 31, 2005	308,500	20.25 - 38.30	29.26	n/a
Granted	97,800	34.29	34.29	n/a
Exercised	(69,300)	20.25 - 31.34	27.15	0.8
Forfeited	(3,000)	31.34 - 34.29	32.52	n/a
Balance outstanding, Dec. 31, 2006	334,000	20.25 - 38.30	31.14	n/a
Granted	100,600	44.48	44.48	n/a
Exercised	(75,850)	20.25 - 34.95	28.73	1.4
Forfeited	(1,000)	44.48	44.48	n/a
Balance outstanding, Dec. 31, 2007	357,750	\$20.25 - 44.48	\$ 35.36	\$ 4.8
Shares available for grant Dec. 31, 2005	1,229,800			
Shares available for grant Dec. 31, 2006	1,135,000			
Shares available for grant Dec. 31, 2007	1,035,400			

In the year ended December 31, 2007, cash of \$2.7 million was received for option shares exercised and a \$0.5 million related tax benefit was realized. The total fair value of options that vested was \$0.2 million in 2007 and \$0.4 million in both 2006 and 2005.

The following table summarizes additional information about stock options outstanding and exercisable at December 31, 2007:

Range of Exercise Prices	Outstanding		Exercisable			
	Stock Options	Weighted-Average Remaining Life in Years	Stock Options	(In millions) Aggregate Intrinsic Value	Weighted-Average Exercise Price	Weighted-Average Remaining Life in Years
\$20.25 - 44.48	357,750	7.35	193,675	\$3.4	\$31.15	6.2

Table of Contents

In accordance with SFAS No. 123R, stock-based compensation expense is recognized within operations and maintenance expense or is capitalized as part of construction overhead. The following table summarizes the allocations of stock-based compensation grants under our LTIP, SOP and ESPP:

Thousands	2007	2006
Operations and maintenance expense	<u>\$ 2,986</u>	<u>\$2,304</u>
Stock-based compensation effect on income before taxes	2,986	2,304
Income taxes	<u>(1,165)</u>	<u>(898)</u>
Net stock-based compensation effect on net income	<u>\$ 1,821</u>	<u>\$1,406</u>
Amounts capitalized	<u>\$ 479</u>	<u>\$ 407</u>

As of December 31, 2007, there was \$0.6 million of unrecognized compensation cost related to the unvested portion of outstanding stock option awards expected to be recognized over a period extending through 2010.

Non-Employee Directors Stock Compensation Plan. In February 2004, the NEDSCP was amended to permit non-employee directors to receive stock awards either in cash or in our stock. As a result of modifications to the directors' compensation arrangements, the NEDSCP was further amended in September 2004 to eliminate any further awards, either in cash or stock, on and after January 1, 2005.

Prior to the latter amendment to the NEDSCP, if non-employee directors elected to receive their awards in stock, approximately \$100,000 worth of common stock was awarded upon joining the Board. These stock awards were subject to vesting and to restrictions on sale and transferability. The shares vested in monthly installments over the five calendar years following the award. On January 1 of each year following the initial award, non-employee directors who elected to receive their awards in stock were awarded an additional \$20,000 worth of restricted stock, which vested in monthly installments in the fifth year following the award (after the previous award had fully vested). We hold the certificates for the restricted shares until the non-employee director ceases to be a director. Participants receive all dividends and have full voting rights on both vested and unvested shares. All awards vest immediately upon the death of a director or upon a change in control of the Company. Any unvested shares are considered to be unearned compensation, and thus are forfeited if the recipient ceases to be a director. The shares were purchased in the open market at the time of the award. During 2006, 7,848 shares vested under the plan and no forfeitures occurred. At December 31, 2007, 5,235 shares remain unvested, all of which are scheduled to vest by December 31, 2008. The weighted-average grant-date fair value of unvested shares at December 31, 2007 and 2006 was \$30.60 and \$28.92, respectively.

Under a separate plan, prior to January 1, 2005 non-employee directors could elect to invest their cash fees and retainers for board service in shares of common stock. Under a deferral plan effective January 1, 2005, such fees and retainers are deferred to a cash account. Cash account balances may be transferred to and invested in a stock account at the election of the director up to four times per year.

Table of Contents

5. LONG-TERM DEBT:

The issuance of first mortgage debt, including secured medium-term notes, under the Mortgage and Deed of Trust (Mortgage), is limited by property additions, adjusted net earnings and other provisions of the Mortgage. The Mortgage constitutes a first mortgage lien on substantially all of our utility property.

The maturities on the long-term debt outstanding, for each of the 12-month periods through December 31, 2012 amount to: \$5 million in 2008; none in 2009; \$35 million in 2010; \$10 million in 2011; and \$40 million in 2012. Holders of certain long-term debt have put options that, if exercised, would accelerate the maturities by \$20 million in both 2008 and 2009.

Thousands (December 31)	2007	2006	2005
Medium-Term Notes			
First Mortgage Bonds:			
6.05% Series B due 2006 ⁽¹⁾	\$ -	\$ -	\$ 8,000
6.31 % Series B due 2007 ⁽²⁾	-	20,000	20,000
6.80 % Series B due 2007 ⁽³⁾	-	9,500	9,500
6.50% Series B due 2008	5,000	5,000	5,000
4.11% Series B due 2010	10,000	10,000	10,000
7.45% Series B due 2010	25,000	25,000	25,000
6.665% Series B due 2011	10,000	10,000	10,000
7.13% Series B due 2012	40,000	40,000	40,000
8.26% Series B due 2014	10,000	10,000	10,000
4.70% Series B due 2015	40,000	40,000	40,000
5.15% Series B due 2016	25,000	25,000	-
7.00% Series B due 2017	40,000	40,000	40,000
6.60% Series B due 2018	22,000	22,000	22,000
8.31% Series B due 2019	10,000	10,000	10,000
7.63% Series B due 2019	20,000	20,000	20,000
9.05% Series A due 2021	10,000	10,000	10,000
5.62% Series B due 2023	40,000	40,000	40,000
7.72% Series B due 2025	20,000	20,000	20,000
6.52% Series B due 2025	10,000	10,000	10,000
7.05% Series B due 2026	20,000	20,000	20,000
7.00% Series B due 2027	20,000	20,000	20,000
6.65% Series B due 2027	20,000	20,000	20,000
6.65% Series B due 2028	10,000	10,000	10,000
7.74% Series B due 2030	20,000	20,000	20,000
7.85% Series B due 2030	10,000	10,000	10,000
5.82% Series B due 2032	30,000	30,000	30,000
5.66% Series B due 2033	40,000	40,000	40,000
5.25% Series B due 2035	10,000	10,000	10,000
	<u>517,000</u>	<u>546,500</u>	<u>529,500</u>
Less long-term debt due within one year	<u>5,000</u>	<u>29,500</u>	<u>8,000</u>
Total long-term debt	<u>\$512,000</u>	<u>\$517,000</u>	<u>\$521,500</u>

⁽¹⁾ Redeemed at maturity in June 2006.

⁽²⁾ Redeemed at maturity in March 2007.

⁽³⁾ Redeemed at maturity in May 2007.

Table of Contents

No long-term debt was issued during 2007. In 2006, we issued and sold \$25 million of 5.15% Series B secured Medium Term Notes (MTNs) due 2016. Proceeds from this sale were used, in part, to repay short-term debt and fund our ongoing utility construction program.

In June 2005, we issued and sold \$50 million of secured MTNs, consisting of \$40 million of the 4.70% Series B secured MTNs due 2015 and \$10 million of the 5.25% Series B secured MTNs due 2035. Proceeds from these sales were used, in part, to redeem \$15 million of maturing MTNs in July 2005, and the balance was applied to our ongoing utility construction program and the repayment of short-term debt.

6. NOTES PAYABLE AND CREDIT FACILITIES:

Our primary source of short-term funds is from the sale of commercial paper notes payable. In addition to issuing commercial paper to meet seasonal working capital requirements, including the financing of gas purchases, gas inventories and accounts receivable, short-term debt is used temporarily to fund capital requirements. Commercial paper is periodically refinanced through the sale of long-term debt or equity securities. Our commercial paper program is supported by a committed credit facility (see below). At December 31, 2007 and 2006, the amounts and average interest rates of commercial paper debt outstanding were \$143.1 million and 4.4 percent and \$100.1 million and 5.3 percent, respectively.

In May 2007, we entered into a credit agreement for unsecured revolving loans totaling \$250 million, replacing the prior \$200 million bilateral credit agreements which were terminated. The new credit facility is available and committed for a term of five years expiring on May 31, 2012, which may be extended for additional one-year periods thereafter subject to lender approval. The credit facility allows us to request increases in the total commitment amount, up to a maximum amount of \$400 million. The credit facility also permits the issuance of letters of credit in an aggregate amount up to the applicable total borrowing commitment. The credit facility continues to be used primarily as back-up credit support for the notes payable issued under our commercial paper program. Commercial paper borrowing provides the liquidity to meet our working capital and interim financing requirements. Under the terms of the credit facility, we pay upfront fees, annual commitment fees and administrative agent fees, but we are not required to maintain compensating bank balances. The interest rates on outstanding loans, if any, under the credit agreement are based on our long-term unsecured debt ratings and on then-current market interest rates. All principal and unpaid interest under the credit facility is due and payable on May 31, 2012, subject to extensions if any. There were no outstanding balances on this credit facility at December 31, 2007 or on prior credit facilities at December 31, 2006.

The credit agreement requires that we maintain credit ratings with Standard & Poor's (S&P) and Moody's Investors Service, Inc. (Moody's) and notify the lenders of any change in our senior unsecured debt ratings by such rating agencies. A change in our debt ratings is not an event of default, nor is the maintenance of a specific minimum level of debt rating a condition of drawing upon the credit facility. However, interest rates on any loans outstanding under the credit facility are tied to debt ratings, which would increase or decrease the cost of any loans under the credit facility when ratings are changed.

The credit facility also requires us to maintain a consolidated indebtedness to total capitalization ratio of 70 percent or less. Failure to comply with this covenant would entitle the lenders to terminate their lending commitments and to accelerate the maturity of all amounts

Table of Contents

outstanding. We were in compliance with this covenant at December 31, 2007, with an indebtedness to total capitalization ratio of 52.7 percent. Our previous credit agreements required us to maintain an indebtedness to total capitalization ratio of 65 percent or less, which we were in compliance with at December 31, 2006.

7. PENSION AND OTHER POSTRETIREMENT BENEFITS:

We maintain two qualified non-contributory defined benefit pension plans, several non-qualified supplemental pension plans for eligible executive officers and certain key employees and other postretirement benefit plans for employees. Only the two qualified defined benefit pension plans have plan assets, which are held in a qualified trust to fund retirement benefits. Effective January 1, 2007, the Retirement Plan for Non-Bargaining Unit Employees and the Welfare Benefits Plan for Non-Bargaining Unit Employees were closed to anyone hired or rehired after December 31, 2006. Instead, newly hired or rehired non-bargaining unit employees will be provided an enhanced Retirement K Savings Plan (RKSP) benefit. Benefits provided to bargaining unit employees under the Retirement Plan for Bargaining Unit Employees are not affected by these changes.

The following table provides a reconciliation of the changes in benefit obligations and fair value of plan assets, as applicable, for the pension and other postretirement benefit plans over the three-year period ended December 31, 2007, and a summary of the funded status and amounts recognized in the consolidated balance sheets using measurement dates of December 31, 2007, 2006 and 2005:

Thousands	Postretirement Benefits					
	Pension Benefits			Other Benefits		
	2007	2006	2005	2007	2006	2005
Reconciliation of change in benefit obligation:						
Obligation at January 1	\$ 269,410	\$ 267,854	\$ 222,948	\$ 22,436	\$ 20,398	\$ 22,729
Service cost	8,708	7,745	6,322	505	555	767
Interest cost	16,057	14,901	13,203	1,293	1,184	1,248
Expected benefits paid	(15,924)	(13,183)	(12,866)	(1,299)	(1,015)	(1,173)
Plan amendments	3,887	-	1,408	-	15	2,384
Change in assumptions	(23,916)	(9,208)	31,642	(645)	133	2,215
Net actuarial (gain) or loss	2,339	1,301	5,197	(104)	1,166	(7,772)
Obligation at December 31	<u>\$ 260,561</u>	<u>\$ 269,410</u>	<u>\$ 267,854</u>	<u>\$ 22,186</u>	<u>\$ 22,436</u>	<u>\$ 20,398</u>
Reconciliation of change in plan assets:						
Fair value of plan assets at January 1	\$ 236,518	\$ 218,555	\$ 186,787	\$ -	\$ -	\$ -
Actual return on plan assets	19,658	30,088	12,558	-	-	-
Employer contributions	1,166	1,058	32,076	1,298	1,015	1,173
Benefits paid	(15,924)	(13,183)	(12,866)	(1,298)	(1,015)	(1,173)
Fair value of plan assets at December 31	<u>\$ 241,418</u>	<u>\$ 236,518</u>	<u>\$ 218,555</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>
Funded status:						
Funded status at December 31	\$ (19,143)	\$ (32,892)	\$ (49,299)	\$ (22,186)	\$ (22,436)	\$ (20,398)
Unrecognized transition obligation	-	-	-	2,058	2,469	2,880
Unrecognized prior service cost	8,212	5,512	6,492	1,866	2,063	2,243
Unrecognized net actuarial loss	20,995	45,862	69,766	1,514	2,288	988
Net amount recognized	<u>\$ 10,064</u>	<u>\$ 18,482</u>	<u>\$ 26,959</u>	<u>\$ (16,748)</u>	<u>\$ (15,616)</u>	<u>\$ (14,287)</u>

Table of Contents

In September 2006, the FASB issued SFAS No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans," which required balance sheet recognition of the overfunded or underfunded status of pension and other postretirement benefit plans. We adopted SFAS No. 158 effective December 31, 2006. For pension plans, the liability is based on the projected benefit obligation. Under SFAS No. 158, any actuarial gains and losses, prior service costs and transition assets or obligations that were not recognized under previous accounting standards must be recognized in accumulated other comprehensive income (AOCI) under common stock equity, net of tax, until they are amortized as a component of net periodic benefit cost. We consider the recognition of the underfunded status of the qualified defined benefit plans and postretirement benefit plans to be subject to regulatory deferral under SFAS No. 71. The unrecognized net gains and losses, prior service costs and transition obligations relating to our qualified defined benefit pension and postretirement benefit plans are recognized as regulatory assets. An estimated \$1.9 million for the qualified plans, consisting of \$1.4 million of prior service costs, transition obligations of \$0.4 million, and negligible actuarial gains, will be amortized from the regulatory asset account to net periodic benefit cost in 2008. The gains and losses, prior service costs and transition obligations related to our non-qualified supplemental pension plans are recognized in AOCI, net of tax, under common stock equity because these expenses are not the basis for regulatory recovery; however, these amounts are not material. In 2008, an estimated \$0.4 million consisting of actuarial gains of \$0.4 million and negligible prior service costs for the non-qualified plans will be amortized from AOCI to net periodic benefit cost.

Our qualified defined benefit pension plans had an aggregate projected benefit obligation of \$243.1 million, \$255.5 million and \$254.4 million at December 31, 2007, 2006 and 2005, respectively, and the fair value of plan assets was \$241.4 million, \$236.5 million and \$218.6 million, respectively. Changes in valuation assumptions impact our projected benefit obligations. The projected benefit obligations at December 31, 2007 decreased \$23.9 million due to an increase in the discount rate assumptions and increased by \$3.4 million due to an increase in the benefit payments for certain retirees. The projected benefit obligations at December 31, 2006 decreased by \$9.3 million, reflecting the increase in the discount rate assumptions, and increased by \$0.3 million, reflecting updates in retirement and withdrawal rates for actual experience. The combination of investment returns and future cash contributions by the company is expected to provide sufficient funds to cover all future benefit obligations of the plans.

An assumed discount rate was determined independently for each pension plan and other postretirement benefit plan based on the Citigroup Above Median Curve (Citigroup curve) using high quality bonds (rated AA- or higher by Standard & Poor's or Aa3 or higher by Moody's Investors Service). The Citigroup curve was then applied to match the estimated cash flows to reflect the timing and amount of expected future benefit payments for these plans.

The expected long-term rate of return on plan assets was developed as a weighted average of the expected earnings for the target asset portfolio. In developing the expected long-term rate of return assumption, consideration was given to the historical performance of each asset class in which the plans' assets are invested and the target asset allocation for plan assets.

Our Investment Policy and Performance Objectives for the qualified pension plan assets held in the Retirement Trust Fund were approved by the Company's retirement committee, which is composed of senior management employees. The policy sets forth the guidelines and objectives

Table of Contents

governing the investment of plan assets. Plan assets are invested for total return with appropriate consideration for liquidity and portfolio risk. All investments are expected to satisfy the requirements of the rule of prudent investments as set forth under the Employee Retirement Income Security Act of 1974. The approved asset classes are cash and short-term investments, fixed income, common stock and convertible securities, absolute and real return strategies, real estate and investments in our common stock. Plan assets may be invested in separately managed accounts or in commingled or mutual funds. Re-balancing will take place periodically as needed, or when significant cash flows occur, in order to maintain the allocation of assets within the stated target ranges. Our expected long-term rate of return is based upon historical index returns by asset class, adjusted by a factor based on our historical return experience and active portfolio management by professional investment managers. The Retirement Trust Fund is not currently invested in any NW Natural securities.

Our pension plan asset allocation at December 31, 2007 and 2006, and the target allocation and expected long-term rate of return by asset category, are as follows:

Asset Category	Percentage of Plan Assets Dec. 31,		Target Allocation	Expected Long-term Rate of Return
	2007	2006		
US Large Cap Equity	18.1%	19.2%	20%	8.50%
US Small/Mid Cap Equity	13.1%	13.9%	15%	9.50%
Non-US Equity	24.9%	23.5%	20%	8.75%
Fixed Income	13.3%	15.6%	15%	5.50%
Real Estate	8.9%	7.7%	8%	7.75%
Absolute Return Strategy	16.3%	14.3%	15%	9.00%
Real Return Strategy	5.4%	5.8%	7%	7.75%
Weighted Average				8.25%

Our non-qualified supplemental defined benefit pension plans' benefit obligations were \$17.5 million, \$13.9 million and \$13.5 million at December 31, 2007, 2006 and 2005, respectively. These plans are not subject to regulatory deferral and the changes in actuarial gains and losses, prior service costs and transition assets or obligations are recognized in AOCI under common stock equity, net of tax, until they are amortized as a component of net periodic benefit cost. Although the plans are unfunded plans with no plan assets due to their nature as non-qualified plans, we indirectly fund our obligations with company- and trust-owned life insurance.

Our plans for providing postretirement benefits other than pensions also are unfunded plans, but are subject to regulatory deferral. The gains and losses, prior service costs and transition assets or obligations for these plans were recognized as a regulatory asset. The accumulated postretirement benefit obligation for those plans was \$22.2 million, \$22.4 million and \$20.4 million at December 31, 2007, 2006 and 2005, respectively.

Net periodic benefit cost consists of service costs, interest costs, the amortization of actuarial gains and losses, the expected returns on plan assets and, in part, on a market-related valuation of assets. The market-related valuation reflects differences between expected returns and actual investment returns, which are recognized over a three-year period from the year in which they occur, thereby reducing year-to-year net periodic benefit cost volatility.

Table of Contents

The following tables provide the components of net periodic benefit cost for the qualified and non-qualified pension and other postretirement benefit plans for the years ended December 31, 2007, 2006 and 2005 and the assumptions used in measuring these costs and benefit obligations:

Thousands	Pension Benefits			Other Postretirement Benefits		
	2007	2006	2005	2007	2006	2005
Service cost	\$ 8,708	\$ 7,745	\$ 6,322	\$ 505	\$ 556	\$ 767
Interest cost	16,057	14,901	13,203	1,293	1,184	1,248
Expected return on plan assets	(18,490)	(17,611)	(14,449)	-	-	-
Amortization of transition obligations	-	-	-	411	411	411
Amortization of prior service costs	1,188	979	1,077	197	195	142
Amortization of net loss	2,123	3,520	2,082	25	1	173
Net periodic benefit cost	<u>\$ 9,586</u>	<u>\$ 9,534</u>	<u>\$ 8,235</u>	<u>\$ 2,431</u>	<u>\$ 2,347</u>	<u>\$ 2,741</u>
Assumptions for net periodic benefit cost:						
Discount rate	6.0%-6.05%	5.75%	6.00%	5.91%	5.75%	6.00%
Rate of increase in compensation	4.0%-5.0%	4.0%-5.0%	4.0%-5.0%	n/a	n/a	n/a
Expected long-term rate of return	8.25%	8.25%	8.25%	n/a	n/a	n/a
Assumptions for funded status:						
Discount rate	6.76%-6.87%	6.0%-6.05%	5.75%	6.56%	5.91%	5.75%
Rate of increase in compensation	4.0%-5.0%	4.0%-5.0%	4.0%-5.0%	n/a	n/a	n/a
Expected long-term rate of return	8.25%	8.25%	8.25%	n/a	n/a	n/a

The assumed annual increase in trend rates used in measuring other postretirement benefits as of December 31, 2007 were 8 percent for medical and 11 percent for prescription drugs. Medical costs were assumed to decrease gradually each year to a rate of 4.50 percent by 2013, while prescription drug costs were assumed to decrease gradually each year to a rate of 4.50 percent by 2014.

Assumed health care cost trend rates can have a significant effect on the amounts reported for the health care plans. A one percentage point change in assumed health care cost trend rates would have the following effects:

Thousands	1% Increase	1% Decrease
Effect on total of service and interest cost components of net periodic postretirement health care benefit cost	\$ 26	\$ (23)
Effect on health care cost component of the accumulated postretirement benefit obligation	\$ 277	\$ (250)

Table of Contents

The following table provides information regarding employer contributions and benefit payments for the two qualified pension plans, the non-qualified pension plans and the other postretirement benefit plans for the years ended December 31, 2007 and 2006, and estimated future payments:

Thousands		
<u>Employer Contributions by Plan Year</u>	<u>Pension Benefits</u>	<u>Other Benefits</u>
2006	\$ 1,527	\$ 1,015
2007	1,606	1,298
2008 (estimated)	1,703	1,794
<u>Benefit Payments</u>		
2005	\$ 12,866	\$ 1,173
2006	13,183	1,015
2007	15,924	1,298
<u>Estimated Future Payments</u>		
2008	\$ 14,809	\$ 1,794
2009	15,522	1,823
2010	16,623	1,887
2011	17,085	1,978
2012	17,897	1,960
2013-2017	100,776	10,183

Our RKSP is a qualified defined contribution plan under Internal Revenue Code Section 401(k). We also have non-qualified deferred compensation plans for eligible officers and senior managers. These plans are designed to enhance the retirement program of employees and to assist them in strengthening their financial security by providing an incentive to save and invest regularly. Our matching contributions to these plans totaled \$1.9 million in 2007, \$1.8 million in 2006, and \$1.7 million in 2005. The RKSP includes an Employee Stock Ownership Plan.

In addition, we make contributions on behalf of each union employee to the Western States Office and Professional Employees Pension Fund, a multi-employer plan. Our contributions totaled \$0.4 million in 2007 and \$0.5 million in both 2006 and 2005.

Table of Contents

8. INCOME TAXES:

A reconciliation between income taxes calculated at the statutory federal tax rate and the tax provision reflected in the consolidated financial statements is as follows:

Thousands, except percentages	2007	2006	2005
Income taxes at federal statutory rate	\$41,495	\$34,877	\$31,804
Increase (decrease):			
Current state income tax, net of federal tax benefit	4,566	3,655	2,913
Federal income tax credits	-	-	(210)
Amortization of investment and energy tax credits	(881)	(994)	(956)
Differences required to be flowed-through by regulatory commissions	(704)	(704)	(704)
Gains on company and trust-owned life insurance	(679)	(913)	(650)
Other - net	244	155	187
Reversal of amounts provided in prior years	19	158	336
Total provision for income taxes	<u>\$44,060</u>	<u>\$36,234</u>	<u>\$32,720</u>
Federal statutory tax rate	35.0%	35.0%	35.0%
Increase (decrease):			
Current state income tax, net of federal tax benefit	3.9%	3.7%	3.2%
Federal income tax credits	0.0%	0.0%	-0.2%
Amortization of investment and energy tax credits	-0.7%	-1.0%	-1.1%
Differences required to be flowed-through by regulatory commissions	-0.6%	-0.7%	-0.8%
Gains on company and trust-owned life insurance	-0.6%	-0.9%	-0.7%
Other - net	0.2%	0.2%	0.2%
Reversal of amounts provided in prior years	0.0%	0.1%	0.4%
Effective tax rate	<u>37.2%</u>	<u>36.4%</u>	<u>36.0%</u>

The provision for income taxes consists of the following:

Thousands	2007	2006	2005
Current tax expense	\$ 48,850	\$ 52,621	\$ 23,034
Deferred tax expense (benefit)	(3,909)	(15,393)	10,642
Deferred investment and energy tax credits	(881)	(994)	(956)
Total provision for income taxes	<u>\$ 44,060</u>	<u>\$ 36,234</u>	<u>\$ 32,720</u>
Total income taxes paid	<u>\$56,215</u>	<u>\$31,270</u>	<u>\$28,479</u>

Table of Contents

The following table summarizes the total provision for income taxes for the regulated utility and other non-regulated business segments for the three years ended December 31:

Thousands	2007	2006	2005
Regulated utility:			
Federal			
Current	\$36,805	\$ 40,979	\$17,848
Deferred	(3,287)	(12,472)	8,691
Deferred investment and energy tax credits	(713)	(756)	(784)
	<u>32,805</u>	<u>27,751</u>	<u>25,755</u>
State			
Current	6,782	7,490	1,649
Deferred	(569)	(2,338)	2,855
	<u>6,213</u>	<u>5,152</u>	<u>4,504</u>
Total charged to regulated utility	<u>39,018</u>	<u>32,903</u>	<u>30,259</u>
Non-regulated business segments:			
Federal			
Current	4,281	3,806	3,581
Deferred	61	(714)	(1,189)
Deferred investment and energy tax credits	(168)	(238)	(172)
	<u>4,174</u>	<u>2,854</u>	<u>2,220</u>
State			
Current	982	346	(44)
Deferred	(114)	131	285
	<u>868</u>	<u>477</u>	<u>241</u>
Total charged to non-regulated business segments	<u>5,042</u>	<u>3,331</u>	<u>2,461</u>
Total provision for income taxes	<u>\$44,060</u>	<u>\$ 36,234</u>	<u>\$32,720</u>

The following table summarizes the tax effect of significant items comprising our deferred income tax accounts for the two years ended December 31:

Thousands	2007	2006
Deferred tax liabilities (assets)		
Utility plant and equipment	\$155,832	\$150,648
Regulatory Adjustment for Income Taxes Paid	2,356	-
Utility other deferred tax differences	477	-
Non-regulated deferred tax differences	3,923	3,893
Deferred tax liabilities	<u>162,588</u>	<u>154,541</u>
Utility regulatory balances	(25,973)	(10,039)
Utility other deferred tax differences	-	(4,053)
Deferred tax assets	<u>(25,973)</u>	<u>(14,092)</u>
Deferred tax liabilities - net	136,615	140,449
Regulatory income tax assets	68,649	67,141
Change in employee post retirement benefit plan liability	(2,118)	(1,413)
Deferred income taxes	<u>203,146</u>	<u>206,177</u>
Deferred investment tax credits	<u>3,194</u>	<u>3,907</u>
Deferred income taxes and investment tax credits	<u>\$206,340</u>	<u>\$210,084</u>

Table of Contents

We have determined that we are more likely than not to realize all recorded deferred tax assets as of December 31, 2007.

The following is a reconciliation of the change in our deferred tax balance for the year ended December 31:

Thousands	2007
Deferred tax expense (benefit), above	\$(3,909)
Increase in differences required to be flowed-through	1,508
Decrease in minimum pension liability included in AOCI	(705)
Decrease in deferred taxes associated with asset held for sale	243
Decrease in deferred investment tax credits	(881)
Change in deferred income tax accounts	<u>\$(3,744)</u>

We calculate our deferred tax assets and liabilities under SFAS No. 109, which requires recording deferred tax balances, at the currently enacted tax rate, on assets and liabilities that are reported differently for income tax purposes than for financial reporting purposes. Deferred tax provisions are not recorded in the income statement for certain temporary differences where regulators require that we flow through deferred income tax benefits or expenses in the utility ratemaking process.

The Internal Revenue Service (IRS) completed its audit of our consolidated income tax returns for the years 2002-2004 in the second quarter of 2006. The focus of the examination was the \$35.8 million net operating loss (NOL) generated in 2004 and carried back to 2002. This loss was primarily due to the deductions claimed for a pension contribution and accelerated depreciation. A federal refund of \$8.3 million was received in October 2005. In conjunction with recording the refund, we recorded additional federal and state income tax credits of \$4.2 million. In addition to the NOL, the IRS examined income tax positions taken with respect to various other ordinary business transactions. We reached agreement with the IRS for certain income tax positions such that a notice of proposed adjustment was issued. As a result of this agreement, we recorded an income tax benefit of \$0.1 million in 2006.

9. PROPERTY AND INVESTMENTS:

The following table sets forth the major classifications of our utility plant and accumulated depreciation at December 31:

	2007		2006	
	Amount	Weighted Average Depreciation Rate	Amount	Weighted Average Depreciation Rate
Thousands, except percentages				
Transmission and distribution	\$1,735,934	3.3%	\$1,657,466	3.3%
Utility storage	112,984	2.6%	110,721	2.6%
General	96,612	3.0%	92,946	2.6%
Intangible and other	71,044	8.8%	68,088	8.6%
Gas stored long-term	14,232	0.0%	12,850	0.0%
Utility plant in service	<u>2,030,806</u>	3.4%	<u>1,942,071</u>	3.4%
Construction work in progress	21,355		21,427	
Total utility plant	2,052,161		1,963,498	
Accumulated depreciation	<u>(615,533)</u>		<u>(574,093)</u>	
Utility plant-net	<u>\$1,436,628</u>		<u>\$1,389,405</u>	

Table of Contents

Accumulated depreciation does not include \$204.9 million and \$187.4 million at December 31, 2007 and 2006, respectively, which represent accrued asset removal costs reflected on the balance sheets as regulatory liabilities (see Note 1, "Plant and Property and Accrued Asset Removal Costs").

The following table summarizes our investments in non-utility plant at December 31:

Thousands, except percentages	2007		2006	
	Amount	Weighted Average Depreciation Rate	Amount	Weighted Average Depreciation Rate
Non-utility storage	\$54,083		\$34,652	
Other	4,881		4,820	
Non-utility plant in service	58,964	2.1%	39,472	2.5%
Construction work in progress	8,185		3,180	
Total non-utility plant	67,149		42,652	
Less accumulated depreciation	(7,904)		(6,916)	
Non-utility plant - net	<u>\$59,245</u>		<u>\$35,736</u>	

The following table summarizes our other long-term investments, including financial investments in life insurance policies accounted for at fair value based on cash surrender values and equity investments in certain partnerships and joint ventures accounted for under the equity or cost methods, at December 31:

Thousands	2007	2006
Life insurance cash surrender value	\$46,294	\$45,234
Note receivable	518	526
Gas pipelines and other	7,258	1,369
Electric generation	-	856
Total other investments	<u>\$54,070</u>	<u>\$47,985</u>

Life Insurance Cash Surrender Value. We have invested in key person life insurance contracts to provide an indirect funding vehicle for certain long-term employee benefit plan liabilities.

Gas Pipelines. A wholly-owned subsidiary of Financial Corporation, KB Pipeline Company, owns a 10 percent interest in an 18-mile interstate natural gas pipeline.

In 2007, we entered into an agreement with TransCanada's Gas Transmission Northwest (GTN) for the purpose of developing, designing, permitting, constructing and owning a pipeline that would connect GTN's interstate transmission line to our local gas distribution system to serve markets in Oregon and the western United States (Palomar Pipeline). During 2007, we incurred expenses totaling \$6.0 million related to planning and permitting.

Electric Generation. In 2007, Financial Corporation sold its ownership interests in wind power electric generation projects located in California (see Note 2).

Table of Contents

FASB Interpretation No. 46(R), "Consolidation of Variable Interest Entities," provides guidance for determining whether consolidation is required for entities over which control is achieved through means other than voting rights, known as "variable interest entities." We currently do not have any significant interests in variable interest entities for which we are the primary beneficiary.

10 FAIR VALUE OF FINANCIAL INSTRUMENTS:

The estimated fair value of NW Natural's financial instruments has been determined using available market information and appropriate valuation methodologies. The following are financial instruments whose carrying values are sensitive to market conditions:

Thousands	Dec. 31, 2007		Dec. 31, 2006	
	Carrying Amount	Estimated Fair Value*	Carrying Amount	Estimated Fair Value
Long-term debt including amount due within one year	\$517,000	\$ 557,916	\$546,500	\$ 595,564

* This estimate is calculated net of commission fees

Fair value of the long-term debt was estimated using market prices in effect on the valuation date. Interest rates for debt with similar terms and remaining maturities were used to estimate fair value for long-term debt issues.

11. USE OF FINANCIAL DERIVATIVES:

We have entered into commodity swaps, an interest rate swap, options and combinations of options for the purchase of natural gas and for the forecasted issuance of fixed-rate debt that qualify as derivative instruments under SFAS No. 133. We primarily utilize derivative financial instruments to manage commodity prices related to natural gas supply requirements and to hedge interest rate risk related to our debt issuances.

In the normal course of business, we enter into indexed-price physical forward natural gas commodity purchase (gas supply) contracts to meet the requirements of core utility customers. We also enter into financial derivatives, up to prescribed limits, to hedge price variability related to the physical contracts. Derivatives entered into prudently for future gas years prior to the PGA filing receive SFAS No. 71 regulatory deferral treatment. Derivatives contracts entered into for core utility customer requirements after the annual PGA rate has been set are subject to the PGA incentive sharing mechanism, whereby 67 percent of the changes in fair value are deferred as regulatory assets or liabilities and the remaining 33 percent is recorded to the income statement for contracts not qualifying for hedge accounting and to Other Comprehensive Income for contracts qualifying for hedge accounting. Our interest rate swap qualifies for hedge accounting under SFAS No. 133. During the fourth quarter of 2006, we entered into a number of commodity-based financial derivatives after our PGA filing. The unrealized mark-to-market losses on these hedges subject to sharing were \$2.9 million, which was recorded as a loss in 2006 and reversed in 2007.

Certain natural gas purchases from Canadian suppliers are payable in Canadian dollars, including both commodity and demand charges, which expose us to adverse changes in foreign currency rates. Foreign currency forward contracts are used to hedge the fluctuation in foreign currency exchange rates for our commodity and commodity-related demand charges paid in

Table of Contents

Canadian dollars. Foreign currency contracts for commodity costs are purchased on a month-to-month basis because the Canadian cost is priced at the average noon-day exchange rate for each month. Foreign currency contracts for demand costs have terms ranging up to 12 months. The gains and losses on the shorter-term currency contracts for commodity costs are recognized immediately in cost of gas. The gains and losses on the currency contracts for demand charges are not recognized in current income but are subject to a regulatory deferral tariff and, as such, are recorded as a derivative asset or liability. These forward contracts qualify for cash flow hedge accounting treatment under SFAS No. 133. The mark-to-market adjustment at December 31, 2007 was an unrealized gain of \$0.1 million. This unrealized gain is subject to regulatory deferral and, as such, was recorded as a derivative asset, which is offset by recording a corresponding amount to a regulatory liability account.

In 2007, we entered into a 10-year, \$50 million fixed-price forward starting interest rate swap contract to hedge the interest rate exposure related to the forecasted issuance of long-term debt. This interest rate swap is an effective cash flow hedge under SFAS No. 133. We did not use any derivative instruments to hedge interest rates in 2006 or 2005.

The unrealized mark-to-market value at December 31, 2007 for all derivative contracts outstanding was a total loss of \$15.4 million consisting of the following unrealized losses: \$10.7 million on commodity-based financial swap contracts, \$2.1 million on commodity-based financial option contracts, \$1.4 million on commodity physical supply contracts and \$1.3 million on an interest rate swap contract. These unrealized losses were offset in part by an unrealized gain of \$0.1 million on foreign exchange forward contracts.

At December 31, 2007 and 2006, the unrealized gains or losses from mark-to-market valuations of our derivative instruments were primarily reported as regulatory liabilities or regulatory assets because the realized gains or losses at settlement are either included, or are expected to be included, in utility rates pursuant to regulatory deferral mechanisms. The estimated fair values of unrealized gains and losses on derivative instruments outstanding, determined using a discounted cash flow model for swaps and a Black-Scholes model for options, were as follows:

Thousands	Fair Value Gains (Losses)			
	Dec. 31, 2007		Dec. 31, 2006	
	Current	Non-Current	Current	Non-Current
Natural gas commodity-based derivative instruments:				
Natural gas commodity hedge contracts	\$(12,099)	\$(2,104)	\$(33,528)	\$(9,583)
Interest rate hedge contract	-	(1,330)	-	-
Foreign currency forward purchase contracts	173	-	(135)	-
Total	<u>\$(11,926)</u>	<u>\$(3,434)</u>	<u>\$(33,663)</u>	<u>\$(9,583)</u>

In 2007 and 2006, we realized net losses of \$42.0 million and \$20.0 million, respectively, from the settlement of fixed-price financial swap contracts which were recorded as increases to the cost of gas. Net realized gains from the settlement of such contracts in 2005 were \$88.9 million and were recorded as decreases to the cost of gas. Realized losses in 2007 were offset by lower gas purchase costs from the underlying hedged floating rate physical supply contracts. The currency exchange rate in all foreign currency forward purchase contracts is included in our cost of gas at settlement; therefore, no gain or loss was recorded from the settlement of those contracts. Any change in value of cash flow hedge contracts that is not included in regulatory

Table of Contents

recovery is included in other comprehensive income. There were no realized gains or losses on the interest rate swap during 2007.

As of December 31, 2007, all of the natural gas hedges mature by or are extendible to October 31, 2009. The maturity date for our interest rate swap contract is September 30, 2018; however, we expect to cash settle this contract concurrently with the issuance of long-term debt in the second half of 2008.

12. COMMITMENTS AND CONTINGENCIES:

Lease Commitments

We lease land, buildings and equipment under agreements that expire in various years through 2046. Rental expense under operating leases was \$4.6 million, \$4.4 million and \$4.1 million for the years ended December 31, 2007, 2006 and 2005, respectively. The table below reflects the future minimum lease payments due under non-cancelable leases at December 31, 2007. Such payments total \$53.0 million for operating leases. The net present value of payments on capital leases less imputed interest was \$1.2 million. These commitments relate principally to the lease of our office headquarters, underground gas storage facilities, vehicles and computer equipment.

Thousands	2008	2009	2010	2011	2012	Later years
Operating leases	\$ 4,257	\$ 4,184	\$ 4,177	\$ 4,140	\$ 4,265	\$ 32,003
Capital leases	532	393	255	26	-	-
Minimum lease payments	<u>\$ 4,789</u>	<u>\$ 4,577</u>	<u>\$ 4,432</u>	<u>\$ 4,166</u>	<u>\$ 4,265</u>	<u>\$ 32,003</u>

Gas Purchase and Pipeline Capacity Purchase and Release Commitments

We have signed agreements providing for the reservation of firm pipeline capacity under which we are required to make fixed monthly payments for contracted capacity. The pricing component of the monthly payment is established, subject to change, by U.S. or Canadian regulatory bodies. In addition, we have entered into long-term sale agreements to release firm pipeline capacity. We also enter into gas purchase agreements. The aggregate amounts of these agreements were as follows at December 31, 2007:

Thousands	Gas Purchase Agreements	Pipeline Capacity Purchase Agreements	Pipeline Capacity Release Agreements
2008	\$ 302,709	\$ 87,453	\$ 5,105
2009	118,936	68,631	5,105
2010	53,253	65,344	4,254
2011	24,106	64,989	-
2012	24,106	49,977	-
2013 through 2027	44,193	131,501	-
Total	567,303	467,895	14,464
Less: Amount representing interest	27,538	61,410	567
Total at present value	<u>\$ 539,765</u>	<u>\$ 406,485</u>	<u>\$ 13,897</u>

Our total payments of fixed charges under capacity purchase agreements in 2007, 2006 and 2005 were \$90.1 million, \$69.2 million and \$83.1 million, respectively. Included in the

Table of Contents

amounts were reductions for capacity release sales of \$5.3 million for 2007 and \$3.7 million for both 2006 and 2005. In addition, per-unit charges are required to be paid based on the actual quantities shipped under the agreements. In certain take-or-pay purchase commitments, annual deficiencies may be offset by prepayments subject to recovery over a longer term if future purchases exceed the minimum annual requirements.

Environmental Matters

We own, or have previously owned, properties that may require environmental remediation or action. We accrue all material loss contingencies relating to these properties that we believe to be probable of assertion and reasonably estimable. We continue to study the extent of our potential environmental liabilities, but due to the numerous uncertainties surrounding the course of environmental remediation and the preliminary nature of several environmental site investigations, the range of potential loss beyond the amounts currently accrued, and the probabilities thereof, cannot be reasonably estimated. We regularly review our remediation liability for each site where we may be exposed to remediation responsibilities. The costs of environmental remediation are difficult to estimate. A number of steps are involved in each environmental remediation effort, including site investigations, remediation, operations and maintenance, monitoring and site closure. Each of these steps may, over time, involve a number of alternative actions, each of which can change the course of the effort. In certain cases, in addition to us, there are a number of other potentially responsible parties, each of which, in proceedings and negotiations with other potentially responsible parties and regulators, may influence the course of the remediation effort. The allocation of liabilities among the potentially responsible parties is often subject to dispute and can be highly uncertain. The events giving rise to environmental liabilities often occurred many decades ago, which complicates the determination of allocating liabilities among potentially responsible parties. Site investigations and remediation efforts often develop slowly over many years. In addition, disputes may arise between potentially responsible parties and regulators as to the severity of particular environmental matters and what remediation efforts are appropriate. These disputes could lead to adversarial administrative proceedings or litigation, with uncertain outcomes.

To the extent reasonably estimable, we estimate the costs of environmental liabilities using current technology, enacted laws and regulations, industry experience gained at similar sites and an assessment of the probable level of involvement and financial condition of other potentially responsible parties. Unless there is a better estimate within this range of probable cost, we record the liability at the lower end of this range. It is likely that changes in these estimates will occur throughout the remediation process for each of these sites due to uncertainty concerning our responsibility, the complexity of environmental laws and regulations and the selection of compliance alternatives. The status of each of the sites currently under investigation is provided below.

Gasco site. We own property in Multnomah County, Oregon that is the site of a former gas manufacturing plant that was closed in 1956 (the Gasco site). The Gasco site has been under investigation by us for environmental contamination under the Oregon Department of Environmental Quality's (ODEQ) Voluntary Clean-Up Program. In June 2003, we filed a Feasibility Scoping Plan and an Ecological and Human Health Risk Assessment with the ODEQ, which outlined a range of remedial alternatives for the most contaminated portion of the Gasco site. In May 2007, we completed a revised upland remediation investigation report and submitted it to the ODEQ for review. During 2007, we accrued an additional \$19.3 million

Table of Contents

for estimated liabilities based on updated information for the development of proposed studies of in-water source control and completion of remedial actions. We have a net liability of \$21.2 million at December 31, 2007 for the Gasco site, which is estimated at the low end of the range of potential liability because no amount within the range is considered to be more likely than another and the high end of the range cannot be estimated.

Siltronic site. We previously owned property adjacent to the Gasco site that now is the location of a manufacturing plant owned by Siltronic Corporation (the Siltronic site). We are currently working with the ODEQ to develop a study of manufactured gas plant wastes on the uplands at this site. During 2007, the estimated liability for this site increased by \$1.8 million related to future expenditures in connection with the study, which is at the low end of the range of potential additional liability because no amount within the range is considered to be more likely than another and the high end of the range cannot be estimated. The net liability at December 31, 2007 for the Siltronic site is \$1.5 million.

Portland Harbor site. In 1998, the ODEQ and the U.S. Environmental Protection Agency (EPA) completed a study of sediments in a 5.5-mile segment of the Willamette River (Portland Harbor) that includes the area adjacent to the Gasco site and the Siltronic site. The Portland Harbor was listed by the EPA as a Superfund site in 2000 and we were notified that we are a potentially responsible party. We then joined with other potentially responsible parties, referred to as the Lower Willamette Group, to fund environmental studies in the Portland Harbor. Subsequently, the EPA approved a Programmatic Work Plan, Field Sampling Plan and Quality Assurance Project Plan for the Portland Harbor Remedial Investigation/Feasibility Study (RI/FS), completion of which is currently expected in 2009. The EPA and the Lower Willamette Group are conducting focused studies on approximately nine miles of the lower Willamette River, including the segment previously studied by the EPA. During 2007, we received a revised estimate and following a review of that estimate, we accrued an additional \$13.6 million for additional expenditures related to RI/FS development and environmental remediation and monitoring after the RI/FS work plan is completed. As of December 31, 2007, we have a net liability of \$13.8 million, which is at the low end of the range of the potential liability because no amount within the range is considered to be more likely than another and the high end of the range cannot be estimated.

In April 2004, we entered into an Administrative Order on Consent providing for early action removal of a deposit of tar in the river sediments adjacent to the Gasco site. We completed the removal of the tar deposit in the Portland Harbor in October 2005 and on November 5, 2005, the EPA approved the completed project. The total cost of removal, including technical work, oversight, consultant fees, and legal fees and ongoing monitoring, was about \$10.4 million. In 2007 we accrued \$0.5 million for additional monitoring and reporting expense. To date, we have paid \$9.8 million on work related to the removal of the tar deposit. As of December 31, 2007, we have a net liability of \$1.0 million, which is at the low end of the range of the potential liability because no amount within the range is considered to be more likely than another and the high end of the range cannot be estimated.

Central Service Center site. In 2006, we received notice from the ODEQ that our Central Service Center in southeast Portland (the Central Service Center site) was assigned a high priority for further environmental investigation. Previously there were three manufactured gas storage tanks on the premises. The ODEQ believes there could be site contamination associated with releases of condensate from stored manufactured gas as a result of historic gas handling

Table of Contents

practices. In the early 1990s, we excavated waste piles and much of the contaminated surface soils and removed accessible waste from some of the abandoned piping. In early 2007, we received notice that this site has been added to the ODEQ's list of sites where releases of hazardous substances have been confirmed and its list where additional investigation or cleanup is necessary. During 2007, we accrued \$0.5 million for estimated liabilities related to the design of an investigational plan for this site in cooperation with the ODEQ. We cannot estimate a range of liability until studies are completed.

Front Street site. The Front Street site was the former location of a gas manufacturing plant operated by our predecessor. Although it is outside the geographic scope of the current Portland Harbor site sediment studies, the EPA directed the Lower Willamette Group to collect a series of surface and subsurface sediment samples off the river bank where that facility was located. Based on the results of that sampling, the EPA notified the Lower Willamette Group that additional sampling would be required. Until the results of that sampling are evaluated, a future cost cannot be reasonably estimated.

Oregon Steel Mills site. See "Legal Proceedings," below.

Accrued Liabilities relating to Environmental sites. Until the current year, we had not been able to determine the timing of our environmental liabilities and therefore had classified no liabilities as current prior to June 2007. The following table summarizes the accrued liabilities relating to environmental sites at December 31, 2007 and 2006:

Thousands	Current Liabilities		Non-Current Liabilities	
	2007	2006	2007	2006
Gasco site	\$ 6,901	\$ -	\$ 14,342	\$ 6,414
Siltronic site	-	-	1,540	43
Portland Harbor site	-	-	14,821	2,149
Central Service Center site	-	-	529	-
Other sites	-	-	167	62
Total	\$ 6,901	\$ -	\$ 31,399	\$ 8,668

Regulatory and Insurance Recovery for Environmental Matters. In May 2003, the OPUC approved our request for deferral of environmental costs associated with specific sites, including the Gasco, Siltronic, Portland Harbor and Front Street sites. The authorization, which was extended through January 2008 and expanded to include the Oregon Steel Mills site, allows us to defer and seek recovery of unreimbursed environmental costs in a future general rate case. Beginning in 2006, the OPUC authorized us to accrue interest on deferred balances, subject to an annual demonstration that we have maximized our insurance recovery or made substantial progress in securing insurance recovery for unrecovered environmental expenses. An application for further extension of the regulatory approval to defer environmental costs and accrued interest is pending. As of December 31, 2007, we have paid a cumulative total of \$24.8 million relating to the named sites since the effective date of the deferral authorization.

On a cumulative basis, we have recognized a total of \$67.8 million for environmental costs, including legal, investigation, and monitoring and remediation costs. Of this total, \$29.5 million has been spent to-date and \$38.3 million is reported as an outstanding liability. At December 31, 2007, we had a regulatory asset of \$63.1 million which includes \$24.8 million of total paid expenditures to date, \$35.1 million for additional environmental accruals for costs expected to be paid in the future and accrued interest of \$3.2 million. We believe the recovery

Table of Contents

of these costs is probable through the regulatory process. We intend to pursue recovery of these environmental costs from our general liability insurance policies, and the regulatory asset will be reduced by the amount of any corresponding insurance recoveries. We consider insurance recovery of some portion of our environmental costs probable based on a combination of factors, including a review of the terms of our insurance policies, the financial condition of the insurance companies providing coverage, a review of successful claims filed by other utilities with similar gas manufacturing facilities, and Oregon legislation that allows an insured party to seek recovery of "all sums" from one insurance company. We have initiated settlement discussions with a majority of our insurers but continue to anticipate that our overall insurance recovery effort will extend over several years.

We anticipate that our regulatory recovery of environmental cost deferrals will not be initiated within the next 12 months because we will not have completed our insurance recovery efforts during that time period. As such we have classified our regulatory assets for environmental cost deferrals as non-current. The following table summarizes the regulatory assets and accrued liabilities relating to environmental matters at December 31, 2007 and 2006:

Thousands	Non-Current Regulatory Assets	
	2007	2006
Gasco site	\$ 29,042	\$ 10,336
Siltronic site	2,227	477
Portland Harbor site	30,869	16,769
Central Service Center site	545	-
Other sites	371	291
Total	<u>\$ 63,054</u>	<u>\$ 27,873</u>

Legal Proceedings

We are subject to claims and litigation arising in the ordinary course of business. Although the final outcome of any of these legal proceedings, including the matter described below, cannot be predicted with certainty, we do not expect that the ultimate disposition of these matters will have a material adverse effect on our financial condition, results of operations or cash flows.

Oregon Steel Mills site. In 2004, NW Natural was served with a third-party complaint by the Port of Portland (Port) in a Multnomah County Circuit Court case, *Oregon Steel Mills, Inc. v. The Port of Portland*. The Port alleges that in the 1940s and 1950s petroleum wastes generated by our predecessor, Portland Gas & Coke Company, and 10 other third-party defendants were disposed of in a waste oil disposal facility operated by the United States or Shaver Transportation Company on property then owned by the Port and now owned by Oregon Steel Mills. The Port's complaint seeks contribution for unspecified past remedial action costs incurred by the Port regarding the former waste oil disposal facility as well as a declaratory judgment allocating liability for future remedial action costs. In March 2005, motions to dismiss by ourselves and other third-party defendants were denied on the basis that the failure of the Port to plead and prove that we were in violation of law was an affirmative defense that may be asserted at trial, but did not provide a sufficient basis for dismissal of the Port's claim. No date has been set for trial and discovery is ongoing. We do not expect that the ultimate disposition of this matter will have a material adverse effect on our financial condition, results of operations or cash flows.

Table of Contents

NORTHWEST NATURAL GAS COMPANY
QUARTERLY FINANCIAL INFORMATION (UNAUDITED)

Thousands, except per share amounts	Quarter ended				Total
	March 31	June 30	Sept. 30	Dec. 31	
2007					
Operating revenues	\$ 394,091	\$ 183,249	\$ 124,245	\$ 331,608	\$ 1,033,193
Net operating revenues	139,008	64,118	49,663	116,253	369,042
Net income (loss)	48,075	2,617	(5,908)	29,713	74,497
Basic earnings (loss) per share	1.77	0.10	(0.22)	1.12	2.78*
Diluted earnings (loss) per share	1.76	0.10	(0.22)	1.11	2.76*
2006					
Operating revenues	\$ 390,391	\$ 170,979	\$ 114,914	\$ 336,888	\$ 1,013,172
Net operating revenues	125,464	61,747	41,341	111,624	340,176
Net income (loss)	41,033	1,994	(9,724)	30,112	63,415
Basic earnings (loss) per share	1.49	0.07	(0.35)	1.10	2.30*
Diluted earnings (loss) per share	1.48	0.07	(0.35)	1.09	2.29*

* Quarterly earnings (loss) per share are based upon the average number of common shares outstanding during each quarter. Because the average number of shares outstanding has changed in each quarter shown, the sum of quarterly earnings (loss) per share may not equal earnings per share for the year. Variations in earnings between quarterly periods are due primarily to the seasonal nature of our business.

Table of Contents

NORTHWEST NATURAL GAS COMPANY
SCHEDULE II - VALUATION AND QUALIFYING ACCOUNTS AND RESERVES

COLUMN A	COLUMN B	COLUMN C		COLUMN D	COLUMN E
	Balance at beginning of period	Additions		Deductions	Balance at end of period
		Charged to costs and expenses	Charged to other accounts	Net Write-offs	
Thousands (year ended Dec. 31)					
2007					
Reserves deducted in balance sheet from assets to which they apply:					
Allowance for uncollectible accounts	\$ 3,033	\$ 2,978	\$ 0	\$ 3,121	\$ 2,890
2006					
Reserves deducted in balance sheet from assets to which they apply:					
Allowance for uncollectible accounts	\$ 3,067	\$ 3,036	\$ 0	\$ 3,070	\$ 3,033
2005					
Reserves deducted in balance sheet from assets to which they apply:					
Allowance for uncollectible accounts	\$ 2,434	\$ 3,034	\$ 0	\$ 2,401	\$ 3,067

108

Table of Contents**ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE**

None.

ITEM 9A. CONTROLS AND PROCEDURES**(a) Evaluation of Disclosure Controls and Procedures**

As of December 31, 2007, the principal executive officer and principal financial officer of Northwest Natural Gas Company (NW Natural) have evaluated the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934, as amended). Based upon that evaluation, the principal executive officer and principal financial officer of NW Natural have concluded that such disclosure controls and procedures are effective to ensure that information required to be disclosed by us and included in our reports filed with the Securities and Exchange Commission (Commission) under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the Commission's rules and forms and are also effective to ensure that information required to be disclosed by us and included in our reports filed with or furnished to the Commission under the Exchange Act is accumulated and communicated to our management as appropriate to allow timely decisions regarding required disclosure.

(b) Changes in Internal Control Over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in the Exchange Act Rule 13a-15(f). There have been no changes in our internal control over financial reporting that occurred during our most recent fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

The statements contained in Exhibit 31.1 and Exhibit 31.2 should be considered in light of, and read together with, the information set forth in this Item 9A.

Management's Report on Internal Control Over Financial Reporting and The Report of Independent Registered Public Accounting Firm appear under Item 8.

ITEM 9B. OTHER INFORMATION**(a) Entry into a Material Service Agreement**

On February 8, 2008, we entered into a service agreement with Northwest Pipeline GP, for an additional 120,000 therms per day of firm transportation capacity from the U.S. Rocky Mountain region upon assignment of the capacity from March Point Cogeneration Company. The primary term of the transportation service agreement will begin on January 1, 2017 and end on December 31, 2046.

This contract is included as Exhibit 10j.(9).

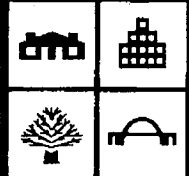
(b) Entry into Service Agreement Amendment

On February 12, 2008, we entered into a service agreement amendment with Northwest Pipeline GP to extend the primary term of the previous agreement, dated June 29, 1990, to September 30, 2044. The amendment also provides an additional 351,550 therms per day of firm transportation capacity from the U.S. Rocky Mountain region.

This contract is included as Exhibit 10j.(7).

Exhibit C

November 2006 Appraisal of the Property



PGP
VALUATION INC

SUMMARY APPRAISAL REPORT

**NORTHWEST NATURAL GAS
FIELD OPERATION CENTER**

730 SW 34th Street
Albany, Oregon



SUMMARY APPRAISAL REPORT

NORTHWEST NATURAL GAS FIELD OPERATION CENTER

730 SW 34th Street
Albany, Oregon

PREPARED FOR

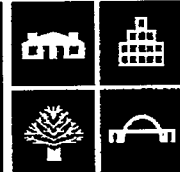
Mr. Steve Walti
Risk Environment & Land Supervisor
Northwest Natural Gas Company
220 NW 2nd Avenue
Portland, Oregon 97209

PREPARED BY

Daniel R. Orman
Donald R. Palmer, MAI
PGP VALUATION INC
110 SW Yamhill, Suite 200
Portland, Oregon 97204-3024
(503) 226-0983

OFFICES IN

Portland – Seattle – San Diego
Sacramento – Vancouver



PGP
VALUATION INC

November 13, 2006

Mr. Steve Walti
Risk Environment & Land Supervisor
Northwest Natural Gas Company
220 NW 2nd Avenue
Portland, Oregon 97209

RE: NORTHWEST NATURAL GAS FIELD OPERATION CENTER
730 SW 34th Street
Albany, Oregon

Dear Mr. Walti:

At your request, we have appraised the captioned property using generally accepted appraisal principles and practices. This appraisal report is intended to comply with the report requirements of the *Uniform Standards of Professional Appraisal Practice (USPAP)* as adopted by the Appraisal Institute.

The appraisal is to be used by the client, Northwest Natural Gas, for decision-making purposes. This appraisal presents the "as is" market value of the fee simple estate. The subject is a small, owner-occupied shop/office industrial complex with a large yard area. Based on the subject's owner use appeal and low site coverage, the cost approach and sales approach have been used to value the property. Due to the uniqueness of the property and its location in a smaller community where there is a limitation of data, the income approach has been omitted. The income approach has limited application for properties of the subject's nature, and therefore, the omission of this approach does not limit the value conclusion.

Based upon our investigation and analysis of available information, the concluded value under the requested scenario is:

MARKET VALUE

Market Value Scenario	Interest	Date	Value
"As Is" Market Value	Fee Simple	November 1, 2006	\$650,000

This valuation assumes that the site and improvements are free of all hazardous waste and toxic materials. Please refer to the Assumptions and Limiting Conditions section for further discussion regarding these issues.

110 SW Yamhill Street, Suite 200
Portland, OR 97204
503.226.0983
503.273.4273 facsimile
www.pgvinc.com

Real Estate Appraisers and Consultants
OFFICES IN CALIFORNIA,
OREGON & WASHINGTON


Mr. Steve Walti
Northwest Natural Gas Company

November 13, 2006
Page 2


The analysis has been prepared by the undersigned. If any questions arise concerning this report, please contact the undersigned.

Sincerely,

PGP VALUATION INC

Daniel R. Orman 

Daniel R. Orman
OR State Certified General Appraiser
No. C000179

Donald R. Palmer 

Donald R. Palmer, MAI
OR State Certified General Appraiser
No. C000060

DRO/DRP
C061164

TABLE OF CONTENTS

Letter of Transmittal

	<u>PAGE</u>
INTRODUCTION	
Appraisal Summary	1
Preliminary Appraisal Information	2
Assumptions & Limiting Conditions	6
DESCRIPTION	
Subject Property Photographs	8
Regional Map	12
Market Area Map	13
Market Area Description	14
Site Description	15
Plat Map	17
Zoning Map	18
Flood Map	19
Description of Improvements	20
Highest & Best Use	23
VALUATION	
Valuation Methodology	25
Cost Approach	26
Land Sales Tabulation Chart	27
Land Sales Location Map	28
Cost Approach Summation Table	32
Sales Comparison Approach	33
Improved Sales Tabulation Chart	34
Improved Sales Location Map	35
Improved Sales Photographs	36
Analysis of Value Conclusions	39
Certification of Appraisal	40
ADDENDA	
Qualifications of PGP VALUATION INC	
Qualifications of Appraisers	

APPRAISAL SUMMARY

Property Type: A light industrial complex with surplus yard area.

Location: 730 SW 34th Street, Albany, Oregon.

Jurisdictional Entities: City of Albany

Reference Parcel Numbers: 11S-4W-13DD-TL 101

Market Area: The subject's neighborhood is a developed industrial area improved primarily with single-tenant industrial buildings, a nearby YMCA, and some secondary commercial uses.

Site Size: 3.25 acres (141,570 SF) according to county records.

Building Size: Three structures: 1) 4,905 SF office/warehouse; 2) 1,440 SF shop; and 3) 793 SF three sided product storage building. The total building area is (4,905 SF + 1,440 SF + 793 SF) 7,138 SF.

Site Coverage: 5 percent (7,138 SF building ÷ 141,570 SF)

Zoning: Heavy Industrial (HI) as designated by the City of Albany.

Highest & Best Use—

As Vacant: Industrial development.

As Improved: As improved, industrial improvements and surplus land.

VALUE SUMMARY

MARKET VALUE

Market Value Scenario	Interest	Date	Value
"As Is" Market Value	Fee Simple	1-Nov-06	\$650,000

PRELIMINARY APPRAISAL INFORMATION

REPORT ORGANIZATION

This report is designed to inform the reader of all factors influencing the property's value in a clear and concise manner. The Preliminary Appraisal Information section provides general information associated with the subject property and this appraisal report. The Description section starts with general market area issues and proceeds to more specific issues directly related to the property. The Highest and Best Use section establishes the premise upon which the property is valued. The Valuation includes application of market information to the subject, as well as a narrative discussion of how the valuation conclusion was established.

PURPOSE, USE, AND USER OF THE APPRAISAL

The purpose of this appraisal is to estimate the subject property's "as is" market value of the fee simple estate for decision making purposes. The intended user of the report is Northwest Natural Gas and its representatives. All other uses and users are expressly prohibited. Reliance on this report by anyone other than the clients or other user specifically approved by PGP Valuation Inc for a purpose not described in this section is prohibited. The authors' responsibility is limited to the client.

DEFINITION OF MARKET VALUE

The following definition as defined by the *Code of Federal Regulations*, Title 12, Volume 3, Part 323.2 (12CFR323.2) has been adopted by the Appraisal Standards Board of The Appraisal Foundation and the Appraisal Institute, with the understanding that it conforms with the reporting requirements of the *2006 Uniform Standards of Professional Appraisal Practice (USPAP)*, and the *Appraisal Standards for Federally-Related Transactions* (12CFR225.61).

Market value means the most probable price which a property should bring in a competitive and open market under all conditions requisite to a fair sale, the buyer and seller each acting prudently and knowledgeably, and assuming the price is not affected by undue stimulus. Implicit in this definition is the consummation of a sale as of a specified date and the passing of title from seller to buyer under conditions whereby:

- (1) Buyer and seller are typically motivated;
- (2) Both parties are well informed or well advised, and acting in what they consider their own best interests;
- (3) A reasonable time is allowed for exposure in the open market;
- (4) Payment is made in terms of cash in U.S. dollars or in terms of financial arrangements comparable thereto; and
- (5) The price represents the normal consideration for the property sold unaffected by special or creative financing or sales concessions granted by anyone associated with the sale.

PRELIMINARY APPRAISAL INFORMATION (continued)

VALUE SCENARIOS DEFINED

"As Is" Market Value refers to the scenario under which a property is evaluated in the condition observed upon inspection as then existing under legal allowed uses without hypothetical conditions, assumptions or qualifications as of the relevant date.

PROPERTY RIGHTS DEFINED

Fee simple interest is defined in *The Dictionary of Real Estate Appraisal*, Third Edition (1993), as:

Absolute ownership unencumbered by any other interest or estate, subject only to the limitations imposed by the governmental powers of taxation, eminent domain, police power, and escheat.

LEGAL DESCRIPTION

A full legal description of the subject property was not available for our review, and is consequently not provided in this report. It is assumed that the tax description accurately describes the subject property.

TAX DESCRIPTION

Tax Lot 101, Section 13DD, Township 11 South, Range 4 West, Willamette Meridian, Linn County, Oregon.

OWNERSHIP AND SALES HISTORY

The subject property is owned by Northwest Natural Gas Co. Corporation. There have been no sale transactions involving the subject within the last three years.

ASSESSMENT AND TAX INFORMATION

The State of Oregon is responsible for the assessment and taxation of the subject. This information is not available. The absence of this data has no detrimental affect on the valuation.

EXPOSURE TIME/MARKETING PERIOD

Exposure time is defined within the *USPAP*, Statement 6, as "The estimated length of time the property interest being appraised would have been offered on the market prior to the hypothetical consummation of a sale at market value on the effective date of the appraisal; a retrospective estimate based upon an analysis of past events assuming a competitive and open market."

Exposure time is best established upon the experience of recent comparable sales. Sales reviewed in the preparation of this report varied widely in marketing periods and exposure times. Based on the subject's location in a well-defined industrial area in a

PRELIMINARY APPRAISAL INFORMATION (continued)

smaller community, and considering current market conditions and the recent exposure periods of similar industrial properties in the Albany area, and assuming the subject is appropriately priced based upon the values concluded in this report and competently promoted, an exposure time of one year or less is anticipated for the subject property.

Marketing period is very similar to exposure time, but reflects a projected time period to sell the property, rather than a retrospective estimate. As such, a similar time period of one year or less is supported for the subject's marketing period.

SPECIFIED FINANCING

Cash to seller, with or without financing.

CASH EQUIVALENCY

This report presents the cash value of the property. This requires that all comparables utilized must be cash transactions or adjusted to "cash" if advantageous seller financing was involved. No adjustments due to seller financing were required.

INSPECTION

Daniel R. Orman inspected the interior and exterior of the subject property on November 1, 2006, with Nancy Whitley of NW Natural Gas. Donald Palmer, MAI, did not inspect the subject property.

SCOPE OF WORK/APPRaisal DEVELOPMENT AND REPORTING PROCESS

The scope of work for this appraisal is to develop an opinion of market value under Standard 1 and report our findings using Standard 2-2. In preparing this report, the appraisers:

- Inspected the interior and exterior of the subject.
- Inspected the subject's market area.
- Reviewed county records for subject data and tax information.
- Performed a highest and best use analysis.
- Researched and confirmed land and improved sales from immediate and competing market areas.
- Inspected the exterior of all the comparables.
- Analyzed supply and demand conditions in the area.
- Applied the cost and sales approach to determine the subject's "as is" fee simple market value.
- A review of the report by Donald R. Palmer, MAI.

PRELIMINARY APPRAISAL INFORMATION (continued)

- Prepared a summary report to present the analysis.

SOURCES OF INFORMATION

The following sources were contacted and/or utilized to obtain relevant information:

<u>Source</u>	<u>Information</u>
Linn County Assessor's Office	Subject tax and market sales research
City of Albany Planning Department	Zoning and community information
PGP VALUATION INC database	Comparable sales information
Multiple Listing Service (WVMLS)	Comparable sales information
Federal Emergency Management Agency	Subject property flood zone information
Multiple brokers and real estate professionals	Comparable sales information

COMPLIANCE AND COMPETENCY RULE

The authors of this report possess the education, knowledge, technical skills, and practical experience to complete this assignment competently, in conformance with the stated regulations.

UNAVAILABILITY OF INFORMATION

All information necessary to develop an estimate of value of the subject property was available to the appraisers except a legal description (please refer to the Assumptions and Limiting Conditions).

PERSONAL PROPERTY, FIXTURES, AND INTANGIBLE ITEMS

This appraisal reports the value of the improved real estate only, exclusive of the value of personal property, trade fixtures, or intangibles.

DEDUCTIONS AND DISCOUNTS

No deductions or discounts were required for this valuation.

ASSUMPTIONS AND LIMITING CONDITIONS

ORDINARY ASSUMPTIONS

This is a Summary Appraisal Report, which is intended to comply with the reporting requirements set forth under Standard Rule 2-2(b) of the *Uniform Standards of Professional Appraisal Practice* for a Summary Appraisal Report. As such, it might not include full discussions of the data, reasoning, and analysis that were used in the appraisal process to develop the appraisers' opinion of value. Additional supporting documentation concerning the data, reasoning, and analysis is retained in the appraisers' file. The information contained in this report is specific to the needs of the client and for the intended use stated in this report. The appraisers are not responsible for unauthorized use of this report.

The analysis assumes the tax description accurately represents the subject property. A legal description has not been provided to the appraisers. If further verification is required, a survey by a registered surveyor is advised.

We assume no responsibility for matters legal in character, nor do we render any opinion as to title, which is assumed to be marketable.

All existing liens, encumbrances, and assessments have been disregarded, unless otherwise noted, and the property is appraised as though free and clear, under responsible ownership, and competent management.

The exhibits in this report are included to assist the reader in visualizing the property. We have made no survey of the property and assume no responsibility in connection with such matters.

Unless otherwise noted herein, it is assumed that there are no encroachments, zoning, or restrictive violations existing in the subject.

The appraisers assume no responsibility for determining if the property requires environmental approval by the appropriate governing agencies, nor if it is in violation thereof, unless noted.

Information presented in this report has been obtained from reliable sources, and it is assumed that the information is accurate.

This report shall be used for its intended purpose only, and by the parties to whom it is addressed. Possession of the report does not include the right of publication.

The appraisers may not be required to give testimony or to appear in court by reason of this appraisal, with reference to the property in question, unless prior arrangements have been made.

The statements of value and all conclusions shall apply as of the dates shown herein. The appraisers have no present or contemplated future interest in the property, which is not specifically disclosed in this report.

Neither all, nor any part, of the contents of this report shall be conveyed to the public through advertising, public relations, news, sales, or other media without the written consent or approval of the authors. This applies particularly to value conclusions and to the identity of the appraisers and the firm with which the appraisers are connected.

ASSUMPTIONS AND LIMITING CONDITIONS (continued)

This report must be used in its entirety. Reliance on any portion of the report independent of others may lead the reader to erroneous conclusions regarding the property values. No portion of the report stands alone without approval from the authors.

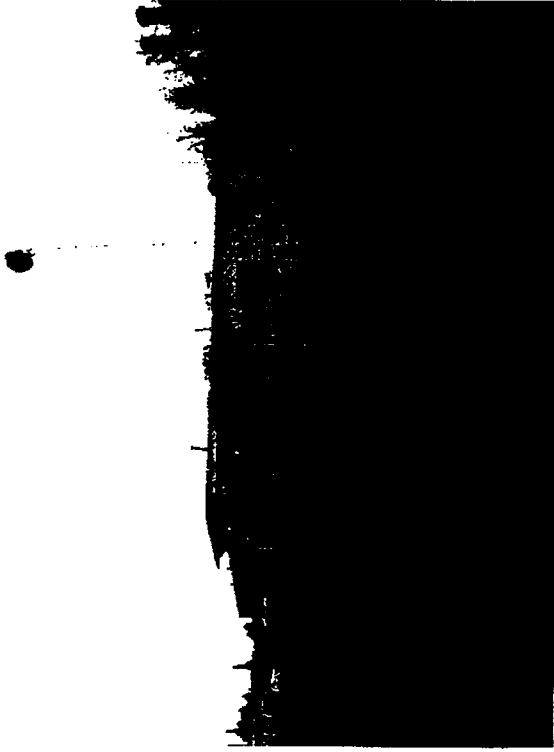
The valuation stated herein assumes professional management and operation of the improvements throughout their lifetime, with an adequate maintenance and repair program.

The liability of PGP VALUATION INC and employees is limited to the client only and only up to the amount of the fee actually received for the assignment. Further, there is no accountability, obligation, or liability to any third party. If this report is placed in the hands of anyone other than the client, the client shall make such party aware of all limiting conditions and assumptions of the assignment and related discussions. The appraisers are in no way responsible for any costs incurred to discover or correct any deficiency in the property. The appraisers assume that there are no hidden or unapparent conditions of the property, subsoil, or structures, which would render it more or less valuable. In the case of limited partnerships or syndication offerings or stock offerings in real estate, the client agrees that in case of lawsuit (brought by lender, partner, or part owner in any form of ownership, tenant, or any other party), any and all awards, settlements, or cost, regardless of outcome; the client will hold PGP Valuation Inc completely harmless.

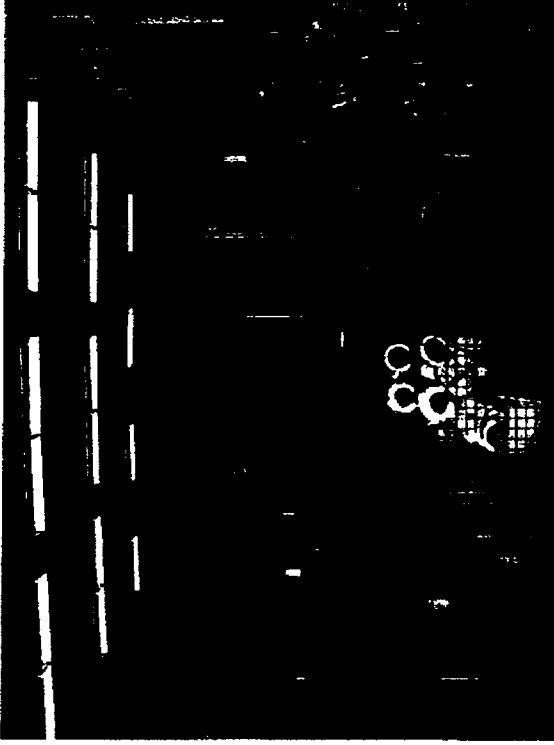
The appraisers are not qualified to detect the presence of toxic or hazardous substances or materials which may influence or be associated with the property or any adjacent properties, has made no investigation or analysis as to the presence of such materials, and expressly disclaims any duty to note the presence of such materials. Therefore, irrespective of any degree of fault, PGP Valuation Inc and its principals, agents, and employees, shall not be liable for costs, expenses, damages, assessments, or penalties, or diminution in value, property damage, or personal injury (including death) resulting from or otherwise attributable to toxic or hazardous substances or materials, including without limitation hazardous waste, asbestos material, formaldehyde, or any smoke, vapors, soot, fumes, acids, alkalis, toxic chemicals, liquids, solids, or gasses, waste materials or other irritants, contaminants, or pollutants.

The appraisers assume no responsibility for determining if the subject complies with the *Americans with Disabilities Act (ADA)*, which prescribes specific building standards which may be applied differently to different buildings, depending on such factors as building age, historical significance, amenability to improvement, and costs of renovation. PGP Valuation Inc its principals, agents, and employees shall not be liable for any costs, expenses, assessments, penalties, or diminution in value resulting from non-compliance. Except as otherwise noted herein, this appraisal assumes that the subject complies with all ADA standards appropriate to the subject improvements; if the subject is not in compliance, the eventual renovation costs and/or penalties would negatively impact the present value of the subject. If the necessary renovation costs time period needed for renovation and penalties for non-compliance (if any) were known today, appropriate deductions would be made to the value conclusions reported herein.

SUBJECT PROPERTY PHOTOGRAPHS



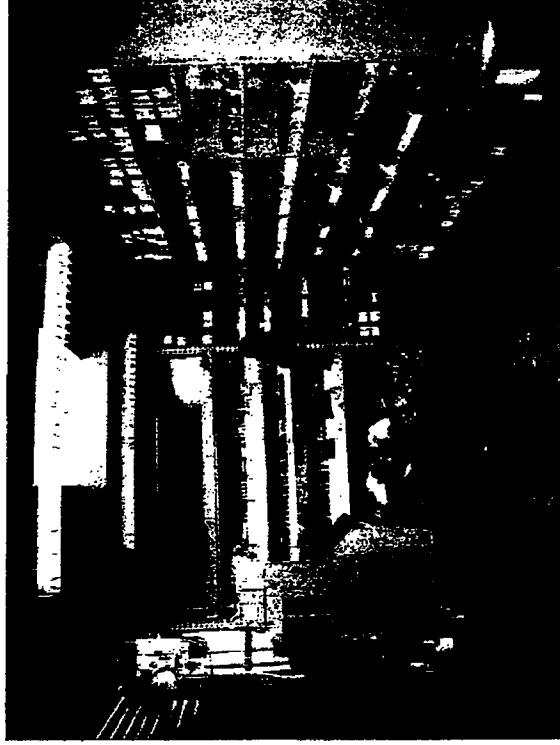
Building 1 – Front Elevation. (C06114-23)



Building 1 – Warehouse. (C061164-08)



Building 1 – Rear Elevation. (C061164-17)



Building 1 – Low Ceiling Warehouse. (C061164-06)

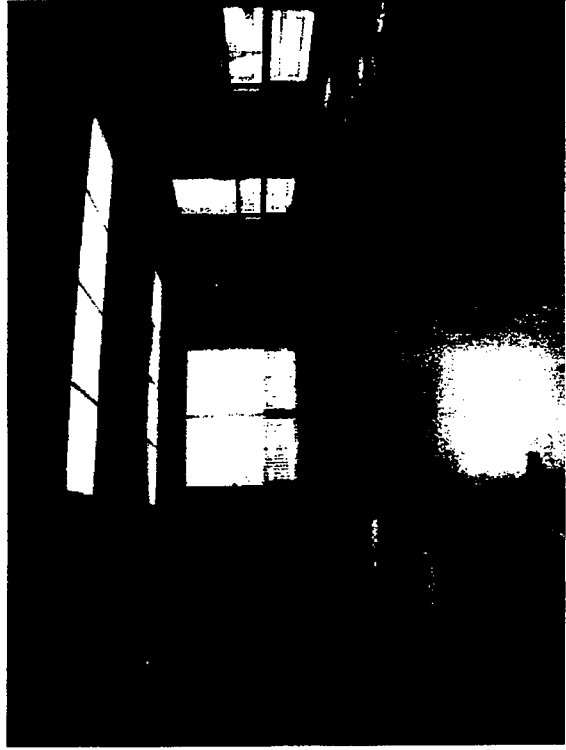
SUBJECT PROPERTY PHOTOGRAPHS (continued)



Building 1 - Finished Area. (C061164-04)



Building 2. (C061164-19)

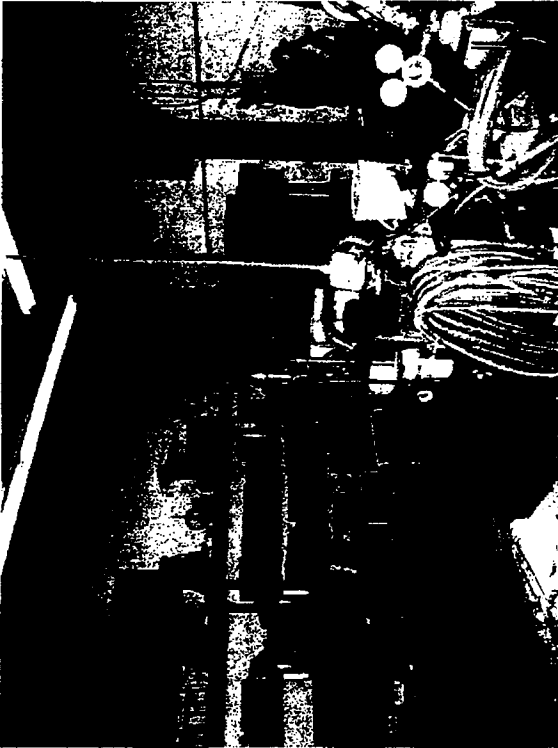


Building 1 - Office. (C061164-05)



Building 2 - Storage Interior. (C061164-10)

SUBJECT PROPERTY PHOTOGRAPHS (continued)



Building 2 - Shop Interior. (C061164-09)



Gravel base yard storage. (C061164-27)



Building 3. (C061164-18)

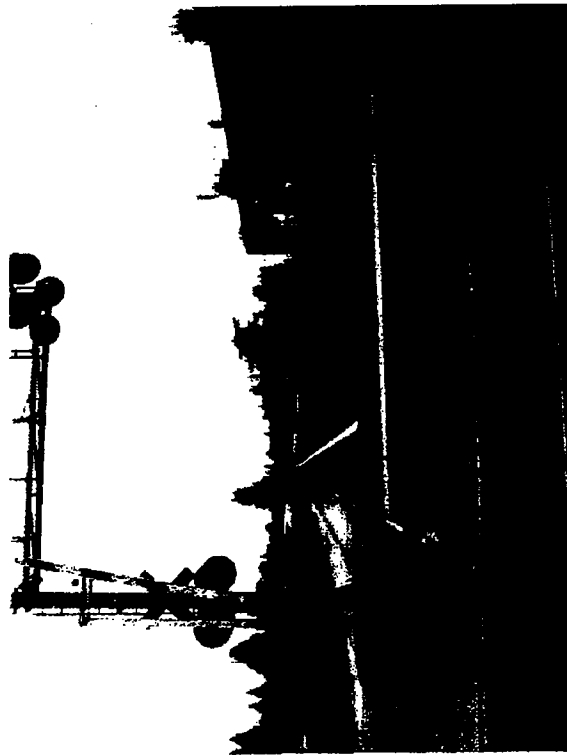


Asphalt base yard storage. (C061164-22)

SUBJECT PROPERTY PHOTOGRAPHS (continued)



Parking. (C061164-24)

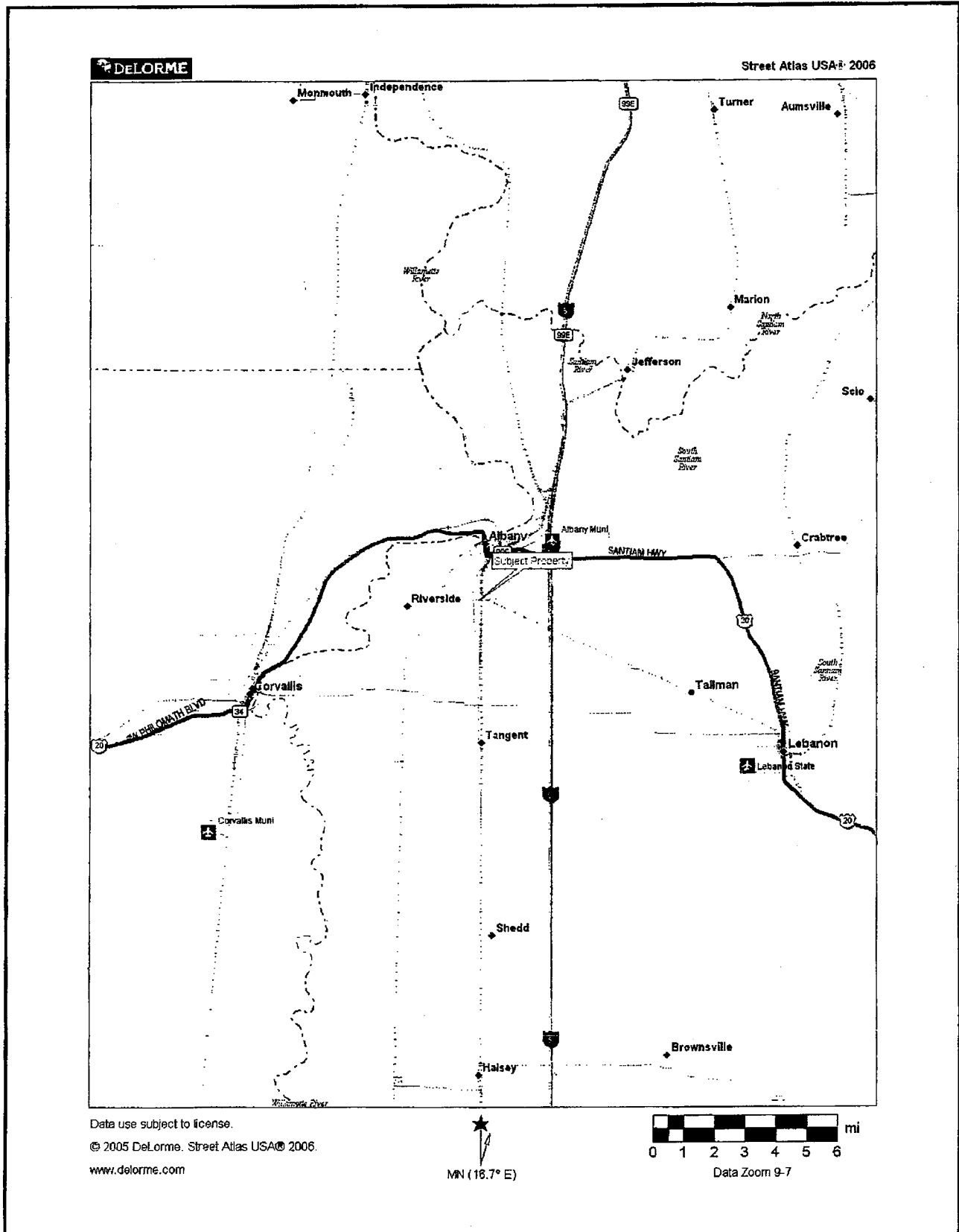


Street Scene: SW 34th Street looking west. (C061164-28)

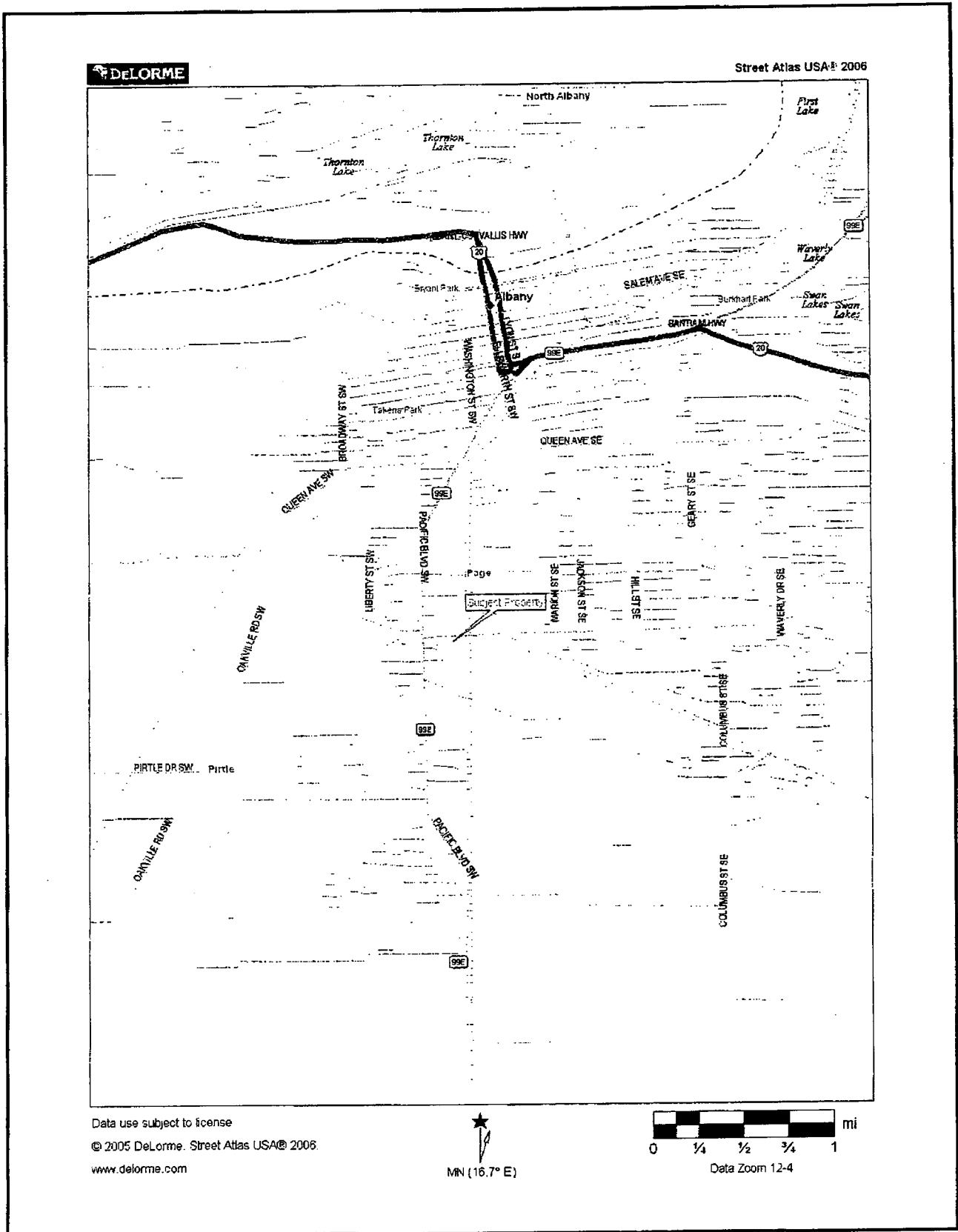


Street Scene: SW 34th Street looking east. (C061164-25)

REGIONAL MAP



MARKET AREA MAP



Data use subject to license
 © 2005 DeLorme. Street Atlas USA® 2006.
 www.delorme.com

MN (18.7° E)

0 1/4 1/2 3/4 1 mi
 Data Zoom 12-4

DESCRIPTION

MARKET AREA

The city of Albany is located in the Mid-Willamette Valley off Interstate 5 in Linn County. Albany is approximately 24 miles south of Salem, 44 miles north of Eugene, 60 miles east of the Pacific Ocean and 40 miles west of the Cascade Mountains. The local community is well oriented to major transportation routes and recreational opportunities. Interstate 5 is the primary interstate that provides access through Oregon from California and Washington. State Highway 99E is a north/south traffic arterial that runs through the central business district of Albany.

Albany is the county seat of Linn County and is the largest incorporated city in the County. Since 1990, growth has averaged approximately 2.9 percent annually. This average is considerably higher than that of Linn and Benton Counties and the State of Oregon. However, between 2000 and 2005, average annual growth slowed to 2.1 percent in Albany.

	1990	2000	2001	2002	2003	2004	2005	Avg. Annual % Change 1990-2005	Avg. Annual % Change 2000-2005
Albany	29,540	40,852	41,650	42,280	43,600	44,030	45,360	2.9%	2.1%
Linn County	91,227	103,069	103,500	104,000	104,900	106,350	107,150	1.1%	0.8%
Benton County	70,811	78,153	79,000	79,900	80,500	81,750	82,835	1.1%	1.2%
State of Oregon	2,842,321	3,421,399	3,471,700	3,504,700	3,541,500	3,582,600	3,631,440	1.6%	1.2%

Source: Center for Population Research & Census- Portland State University

Linn County's overall unemployment rate continues to stay above the state and national level. According to Oregon Employment Department, the current (September 2006) unemployment rate for Linn County was 5.8 percent; this is below the September 2005 rate of 6.5 percent. The current statewide rate is 4.8 percent and the national rate is 4.4 percent. Neighboring Benton County is consistently lower than Linn County.

Residential development is distributed throughout the city, but primarily concentrations are north and south of Knox Butte Road and east of Interstate 5, in north Albany north of the Willamette River, and in the extreme western portion of the city. Multi-family development is located in pockets around the city and typically serves as a buffer between commercial and industrial zoned land and single family residential development. The majority of the multi-family development was constructed between 1975 and 1983; however, there has been significant new single family residential growth in recent years.

Commercial development is primarily located near Interstate 5, along Highway 99E and Highway 20, and in the downtown area. The Heritage area has seen some of the more recent commercial development in the Albany area. Major projects in this area include the Heritage Mall, an enclosed regional mall, Fred Meyer store, Bi-Mart Center, Heritage Plaza, Periwinkle Plaza, and Albany Plaza. These developments are primarily located between Geary Street and Waverly Drive on the west and east, and 14th Avenue and Highway 99E on the south and north. The central business district consists of older service-related businesses and city and country offices. Office development in

DESCRIPTION (continued)

Albany typically consists of smaller, multi-tenant office buildings located off of secondary neighborhood streets and in the downtown area.

The realignment of the Pacific Boulevard and Santiam Highway intersection is the most significant infrastructure change in recent years. This has paved the way for redevelopment of secondary buildings given the improved traffic flow and access. At this intersection, new development includes a Walgreen's, Goodwill, Oil Can Henry's, and a fast food restaurant. In 2006, Mervyn's announced that it will be closing its Albany branch (61,000 SF building); however, Kohl's department store is planning on demolishing this structure and rebuilding a 69,000 square foot commercial building. This is scheduled during 2007.

The industrial development in Albany is concentrated between Pacific Boulevard and Marion Street SE, south of Pacific Boulevard's north boundary and north of 41st Avenue. Development varies considerably from owner-occupied properties to single-tenant and multi-tenant leased properties. The majority of the industrial development consists of smaller projects, and most of the newer properties in the market are of steel construction.

In south Albany, along Highway 99, is the Target Distribution Center that is on a 105 acre site. This facility was first developed in the mid 1990's with an addition in 2000. The total building area is approximately 1.4 million square feet. Also in this area, PepsiCo will build a 900,000 square foot production facility and a 400,000 square foot packaging facility on a 200 acre site. Completion is expected by fall 2008, with an estimated 200 employees to be initially hired. In five years, employment could be up to 500.

Albany has a wide range of commercial and retail uses, with significant industry and a supporting residential base. The outlook for the area is positive, with steady, moderate growth anticipated.

SITE

Environmental Risks:

There is an underground fuel tank located near the center of the subject site. Annual testing by the current owner indicates that there has been no leaking. This appraisal assumes that the site is free from all hazardous materials and environmental risks. The appraisers conducted no independent investigation regarding this issue. Please see the Assumptions and Limiting Conditions.

Shape/Topography:

Effectively rectangular (see plat map) and level. The eastern portion of the site is slightly below street grade.

Site Size:

3.25 acres (141,570 SF) according to county records.

Access:

The subject has good overall access and average immediate access for an industrial site.

DESCRIPTION (continued)

Street Description and Exposure:

SW 34th Street is a collector street that connects Highway 99 (aka Pacific Boulevard) to the west, with Waverly Drive to the east. SW 34th Street has four-lanes and is improved with an asphalt paved surface, sidewalks, curbs, storm drains and street lighting. On-street parking is not allowed. Street exposure is good.

Zoning:

Heavy Industrial (HI) by the City of Albany. This zone is intended primarily for industrial uses and support activities. Contractors and industrial services, manufacturing and production, railroad yard, and warehousing and distributions are allowed with site plan review. Commercial, institutional, and residential uses are not allowed. The subject's existing use and design meet the standards of this zoning and the overlays.

Flood Plain Data:

According to the National Flood Insurance Program Rate Map, Panel 4101370005F, dated July 7, 1999, the subject is in Zone x (not shaded), areas outside the 500-year flood plain.

Wetlands:

Reportedly, there is a small wetland area near the southeast perimeter of the site. This area appears to be a relatively small/narrow area along the south property line. Recognizing the location and size, the wetlands does not diminish the utility of the site. If questions arise regarding this matter, further research is advised.

Surrounding Properties:

SW 34th Street to the west that separates the subject from a YMCA campus and an industrial building; railroad tracks to the east and then an industrial building; unimproved industrial land to the south; and a metal scrap yard to the west.

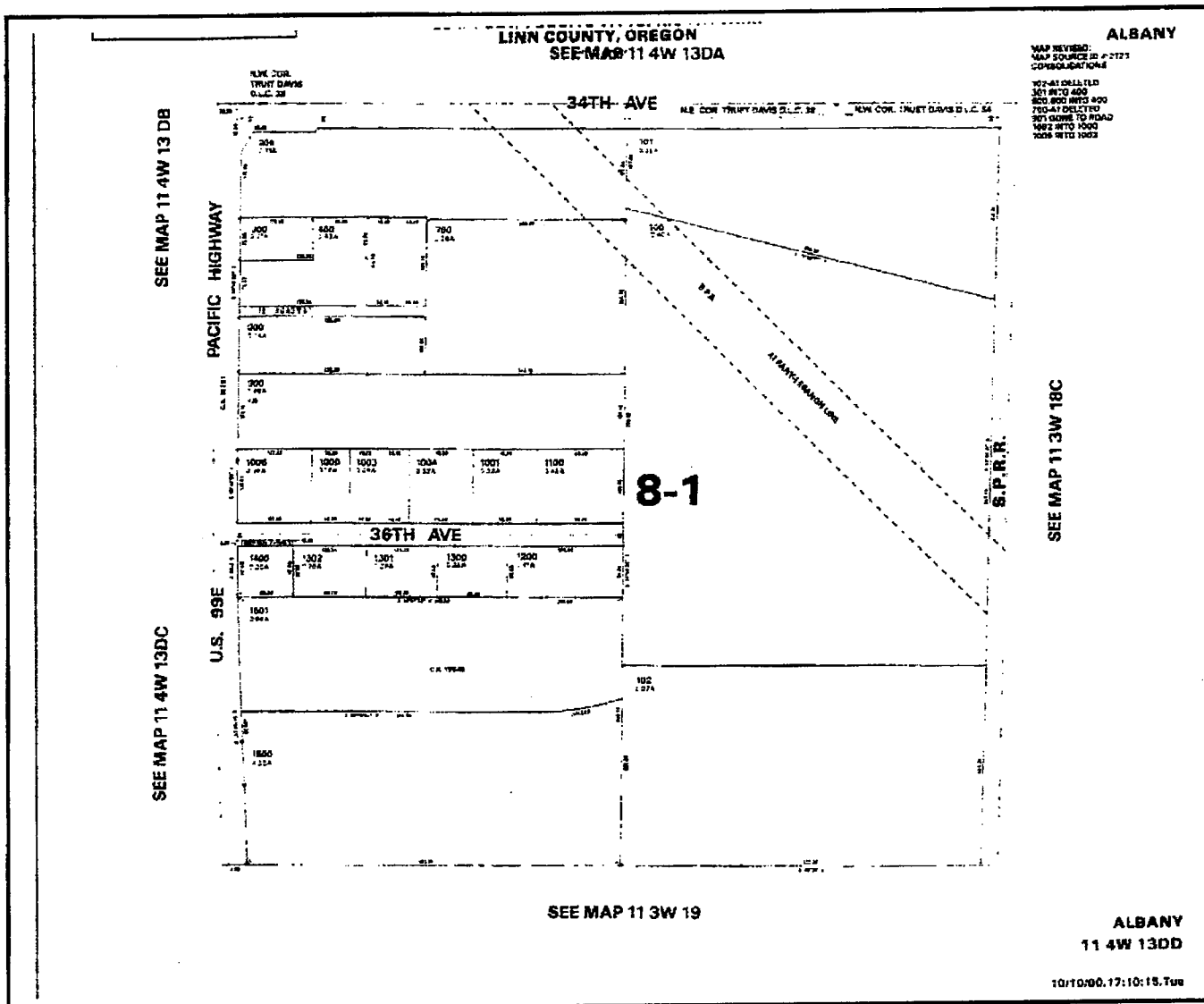
Utilities:

All public utilities are available to the site.

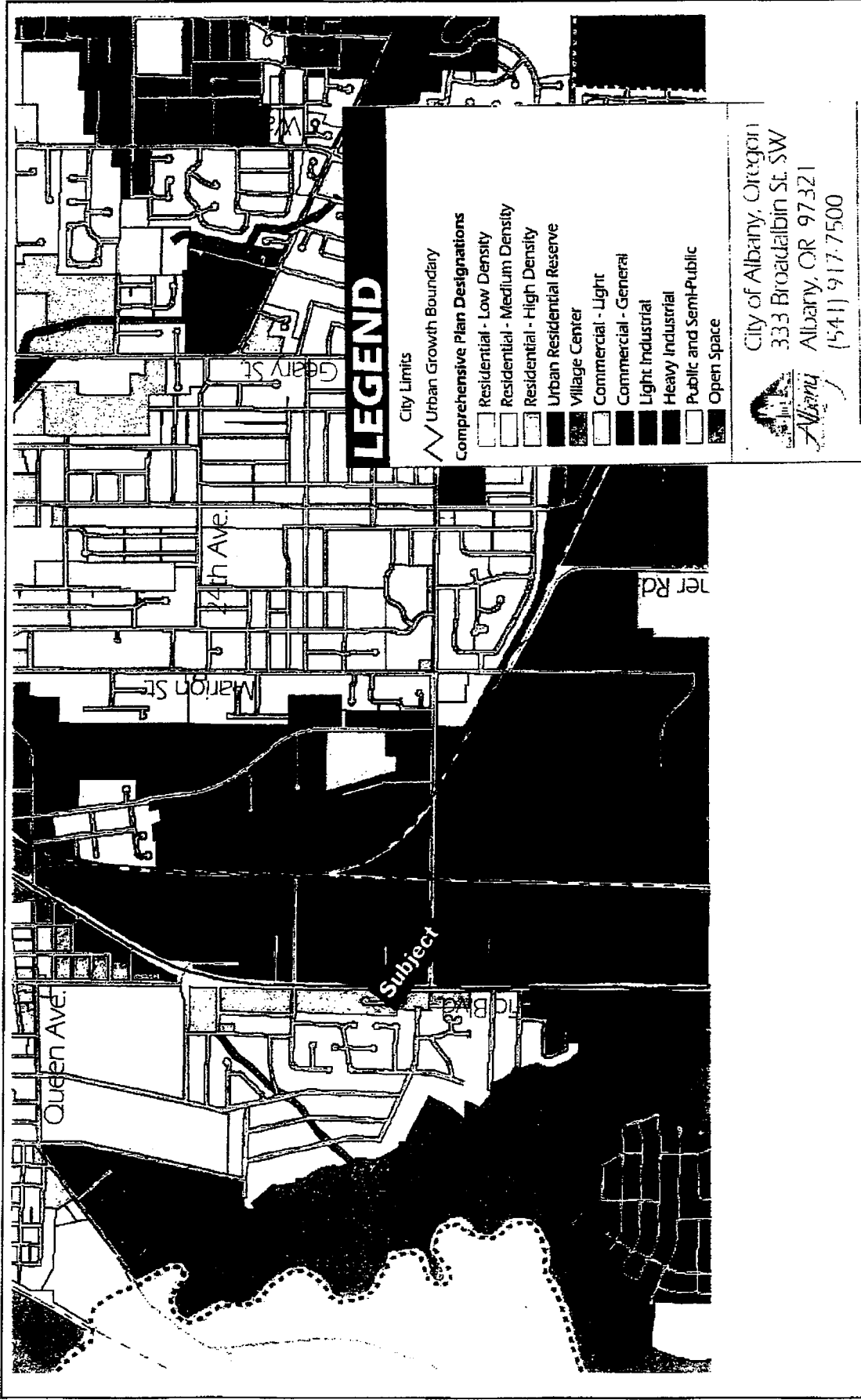
Easements, Encroachments and Encumbrances:

A preliminary title report was not provided to the appraisers. The Plat Map shows a BPA power line easement bisecting the tip of the southwest corner of the site; however, this does not have adverse impact on the subject property. Based upon physical inspection of the site, there does not appear to be any adverse easements or other encumbrances. If questions arise regarding easements, encroachments, or other encumbrances, further research is advised.

PLAT MAP



ZONING MAP



FLOOD MAP

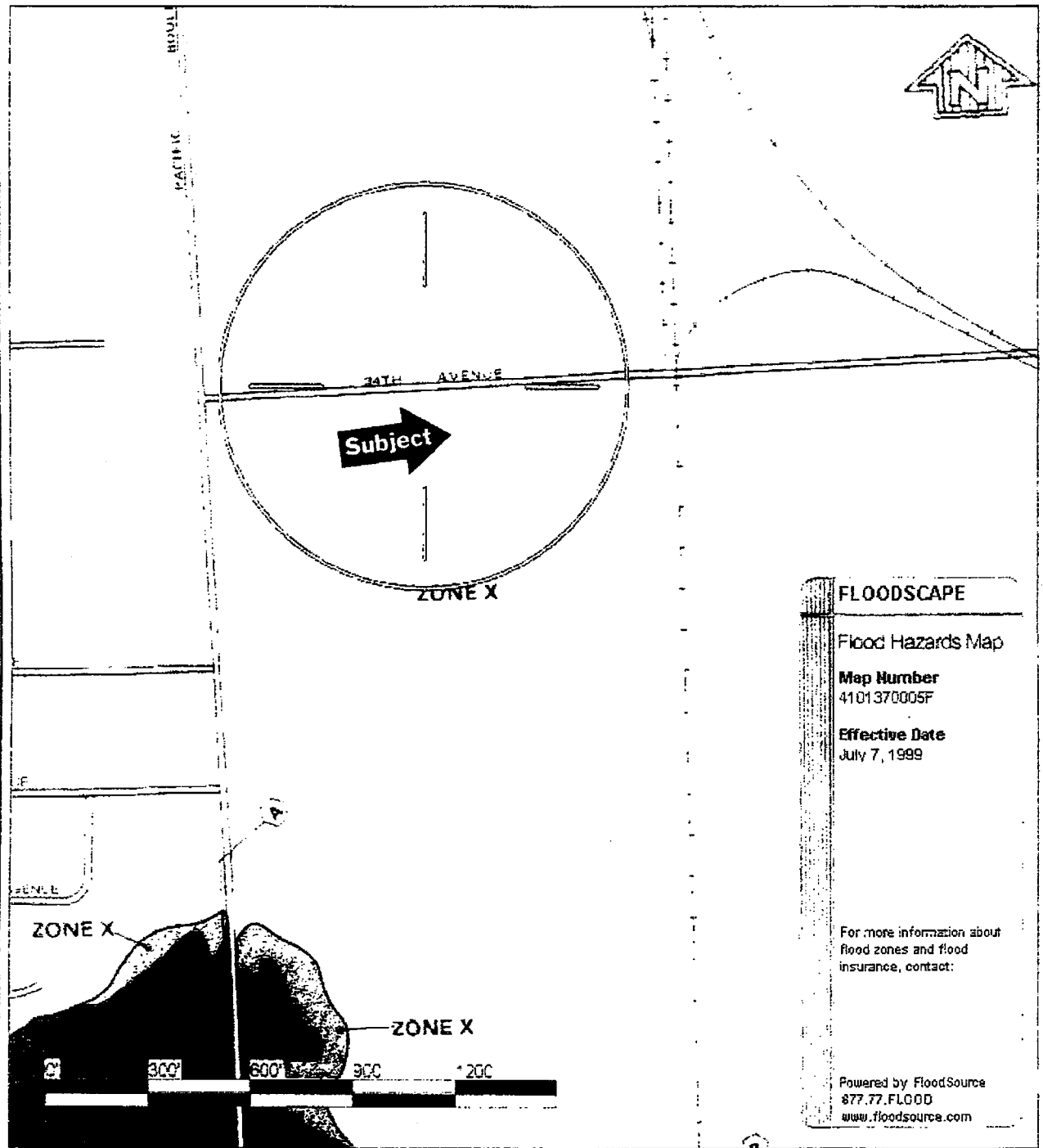
InterFlood



www.interflood.com • 1-800-252-6633

Prepared for:
PGP Valuation Inc

730 34th Ave SW
Albany, OR 97322-3829



© 1999-2006 SourceProse and/or FloodSource Corporations. All rights reserved. Patents 6,631,326 and 6,678,615. Other patents pending. For Info: info@floodsource.com.

DESCRIPTION OF IMPROVEMENTS

Environmental Risks: This appraisal assumes the improvements are free of all hazardous materials and environmental risks. The appraisers conducted no independent investigation regarding this issue. Please see the Assumptions and Limiting Conditions.

General Description: A three building, owner occupied, industrial facility with surplus land.

Year Built—
Building 1: 1961 with a 1972 addition.
Building 2: 1992
Building 3: 1961

Effective Age: The estimated average effective age is 25 years.

Building Size: Three structures: 1) 4,905 SF office/warehouse; 2) 1,440 SF shop; and 3) 793 SF three sided product storage building. The total building area is (4,905 SF + 1,440 SF + 793 SF) 7,138 SF. The building sizes were based on the field appraiser's measurements and calculations.

Office: There is approximately 2,492 SF of below average quality/condition office space in Building 1. This represents 39% of the total.

Site Coverage: 5 % (7,138 SF building ÷ 141,570 SF). This coverage is low relative to other industrial buildings that have coverage ratios from 20 to 35%. This indicates that excess/surplus land is present. This will be addressed in the highest and best use section.

Construction Materials (Building 1)—

Foundation: Concrete slab on grade.
Exterior Walls: Concrete block.
Roof Structure: Wood beam and purlins.
Roof Cover: Assumed built-up composition (or equivalent).

There is 2,492 SF of interior office in Building 1. This space has vinyl tile square flooring, drop ceiling, recessed fluorescent tube lighting, and gypsum board demising walls. There is a small women's restroom (toilet/sink) and a large men's locker room (with showers, two toilets, two urinals, and two sinks). This locker room has non-slick floors. The office has heating and air conditioning. The quality and condition is fair to average.

DESCRIPTION OF IMPROVEMENTS (continued)

There are two warehouse areas in Building 1: 1,657 SF that has approximately 16 to 18-foot clear height, and 756 SF that has an approximate 10-foot clear height. Both of these areas have exposed concrete floors and exposed roof beams. Heat only is provided by suspended gas heaters. Grade level overhead truck doors serve both warehouse areas.

Construction Materials (Building 2)—

Foundation:	Concrete slab on grade.
Framing:	Light metal construction.
Exterior Walls:	Metal clad siding.
Roof Structure:	Metal roof truss.
Roof Cover:	Standing seam metal.

This building is divided into two spaces. One space is used as a welding shop and the other side for storage, with a grade level overhead door serving both sides. The flooring is concrete, the ceiling trusses and insulation (wall & ceiling) are exposed. Heat only is provided by suspended gas heaters, and lighting is by hanging fluorescent tube fixtures. There is no plumbing.

Construction Materials (Building 3)—

Foundation:	Concrete slab on grade.
Exterior Walls:	Concrete block.
Roof Structure:	Wood truss.
Roof Cover:	Standing seam metal.

This is a three sided building that is open on the north side. It is used for product storage. There is no plumbing or electrical, the flooring is concrete.

Deferred Maintenance:

None noted during the inspection.

Fuel Pump/Storage:

There is one fuel pump/dispenser, and a small underground diesel fuel tank (double wall construction; installed in 1992). It was reported that an annual pressure test for leaks is performed, and no leaking has been detected. Please refer to the Assumptions and Limiting Conditions for a disclaimer.

Site Improvements:

The subject property is fenced on all sides with an approximate 6-high cyclone fence and three strand barbed wire. Approximately 2.09 acres of the site has an asphalt paved surface, with the balance of the site being graveled. The asphalt is in average condition. There is no significant landscaping.

DESCRIPTION OF IMPROVEMENTS (continued)

Improvement Summary:

In its current condition, the subject is a three building industrial facility that has surplus land. Building 1 is fair to average with regard to condition and quality, and Building 2 is above average. These two buildings have utility for shop, warehouse, and light manufacturing, with Building 3 having utility for product storage.

HIGHEST & BEST USE

The highest and best use of a property is defined as that reasonable and most probable use that will support its highest present value. The highest and best use, or most probable use, must be legal, physically possible, and marketable. This concept is based upon traditional appraisal theory and reflects the attitudes of typical buyers and sellers who recognize that value is predicated on future benefits. This theory is based upon wealth maximization of the owner, with consideration given to community goals. A use, which does not meet the needs of the public, will not meet the above highest and best use criteria.

The highest and best uses of the subject site "as vacant" and "as improved" is discussed below.

"AS VACANT"

Based on the subject's industrial zoning (HI), the number of industrial uses surrounding the site, and the subject's overall location and access, industrial development is supported as the highest and best use of the site "as vacant". This use is supported by market conditions, with no adverse supply and demand conditions noted. Therefore, the highest and best use of the site as though vacant is for industrial development.

"AS IMPROVED"

As discussed previously, legal and location characteristics support an industrial use. The subject's current development and use are allowed in the HI zone. As noted in the improvement description, the subject is a functional light manufacturing/shop complex. Building 1 of the subject has utility for light manufacturing, warehouse, and supporting office. Building 2 has utility for shop/warehouse use, and Building 3 for product storage. There is a large amount of surplus land that is currently used for parking and yard storage, but also has utility for expansion. Properties with ample yard space are highly desirable for many industrial users. Improved Sale 2, 4 and 5 each had surplus land areas that were fully utilized for yard storage. Overall, the subject's design provides utility to a wide range of industrial users.

Based upon legal and physical considerations, the property's current use, a light industrial building with surplus land is supported as its highest and best use "as improved."

In addition to legal, physical, and locational considerations, analysis of the subject property "as improved" requires the treatment of two important issues: (1) consideration of alternative uses of the property; and (2) the marketability of the most probable use. The five possible alternative treatments of an improved property are: demolition, expansion, renovation, conversion, and continued use "as improved". Each of these uses has been considered with the continued use "as improved" being the maximally productive use relative to the other options, with expansion possible due to the presence of surplus land.

HIGHEST & BEST USE (continued)

Regarding the marketability of the subject, the Albany marketplace appears to be in a relatively good state of balance. The comparables used in the sales comparison approach each sold within nine months, indicating good marketability. Also, four of the five sales were sold to owner users, suggesting that the subject would likely sale to an owner occupant (versus an investor). Overall, market conditions support an industrial use with surplus land. Potential buyers would include: 1) a user that requires the surplus land for parking and/or yard storage; 2) a user that will expand the facility with other buildings; or 3) a user requiring the buildings and supporting land and potentially sell the surplus land area as excess. All scenarios would render an approximate equivalent value.

Overall, the subject's current use is supported as the highest and best use of the property.

VALUATION

The next part of the appraisal deals directly with the valuation of the property. Traditional appraisal methods to valuation include the cost approach, income approach, and sales comparison approach. The valuation methodology utilized is summarized below.

METHODOLOGY

The **cost approach** is based upon the principle that the value of property is significantly related to its physical characteristics and that no one would pay more than the cost to build a like facility in today's market on a comparable site. In this approach, the market value of the site is estimated and added to the depreciated value of the improvements. In addition, entrepreneurial profit is added. For proposed or newer properties, this approach may have significant relevance. Considering the subject's low site coverage (i.e., significant value is created by the land component) and the construction characteristics, the cost approach will be presented.

The **income capitalization approach** is based on the premise that industrial properties are income producing, and that investors purchase these properties based on their income-producing ability. In the Income Capitalization Approach, market rents for the subject are estimated, the applicable operating expenses are deducted, and the resulting net income is capitalized into a value estimate. However, the subject property's design is primarily attractive to owner-users, not investors. Owner-users place little emphasis on the income approach when making purchasing decisions. In addition, the small building size, low coverage ratio, and varying building types create limitations on the number of similar lease comparables. Consequently, this approach has been omitted from this analysis.

The **sales comparison approach** is based on the principle of substitution. This principle states that no one would pay more for the subject than the value of a similar property in the market. In active markets, with a large number of physically similar comparables, this approach is generally considered to be a good indicator of value. For atypical properties like the subject, this approach can be limited due to the wide variance in property specific characteristics.

ANALYSIS OF VALUE CONCLUSIONS

The approaches used to value the subject property (cost and sales) are correlated into a final fee simple market value estimate at completion in the Analysis of Value Conclusions section.

COST APPROACH

In this section, the subject's concluded site value will be added to the depreciated replacement cost of the improvements, which accounts for estimated improvement costs, absorption costs, and entrepreneurial profit and overhead, less estimates for accrued depreciation.

SITE VALUATION

The market value of the subject site will be estimated utilizing the sales comparison approach in which sales of industrial land in the subject's market area and directly competing market areas are compared to the subject site to indicate value. The limited number of comparable sales in the subject's market area and lack of uniformity within this market prevents direct extraction of adjustments from the marketplace. General analysis reflecting market behavior is utilized to determine which comparables are superior or inferior to the subject. This analysis establishes value parameters for the subject, allowing for a final conclusion of value.

The price per square foot unit of comparison will be used in this analysis. This indicator best reflects the behavior of the typical buyer and seller in the subject's market. Located on the following pages are a Land Sales Tabulation Chart and Land Sales Location Map, which summarize the comparables used in this analysis.

The four comparable land sales indicate a range in price from \$2.63 to \$3.50 per square foot. Although some of the comparables are slightly dated, land values have remained generally stable over the past few years, and therefore, a time adjustment is not required.

Comparable 3 (\$3.50/SF) is a 2001 industrial land sales in the subject's Albany market area. It has similar size and site characteristics (topography/shape), but the comparables frontage along Interstate 5 freeway has enhanced its marketability and value, noting that a furniture retailer was the buyer. Due to this, it is a high indicator for the subject.

Comparable 2 (\$2.83/SF) is the 2003 sale of a smaller industrial parcel located near the subject. This location, and general site characteristics, makes Comparable 2 a reasonable indicator for the subject.

Comparable 1 (\$2.60/SF) is the recent sale of a smaller industrial site located in the subject's industrial area, with superior direct access and exposure. The smaller size and superior access and exposure make this a high indicator.

Comparable 4 (\$2.73/SF) is a current listing in the subject's industrial area, with similar access and exposure. Secondary weight is placed on this comparable due to its listing status.

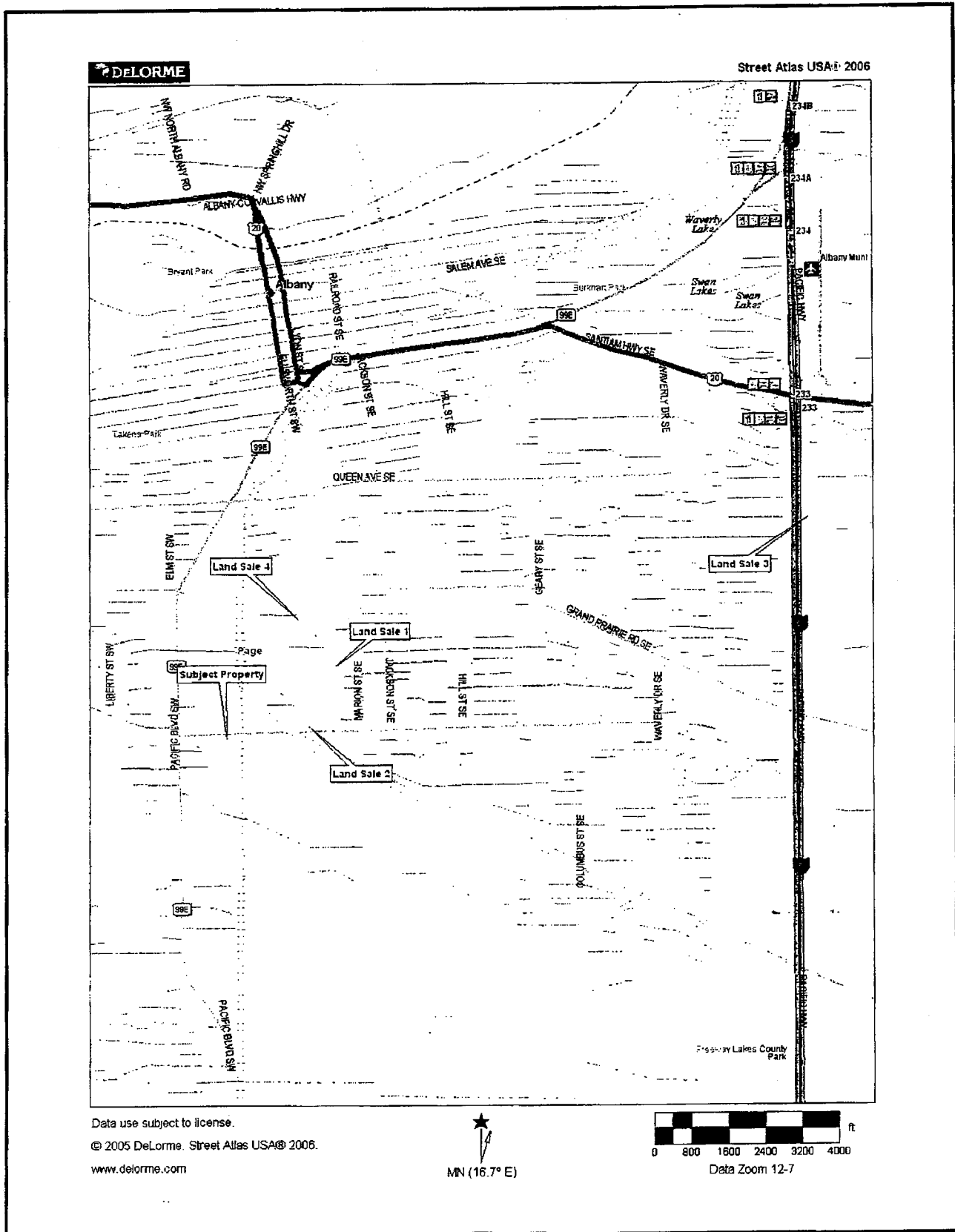
In addition to the preceding data, anecdotal data is considered. Jim O'Bryant, an active industrial broker in Albany, reported industrial land values varying from \$2.50 to \$3/SF. Also, Rob Richards of Coldwell Banker – Albany, suggested a \$2.50/SF value for industrial land similar to the subject.

Narrative continues on page 29.

LAND SALES TABULATION CHART

LOCATION INFORMATION	COMPARABLE 1	COMPARABLE 2	COMPARABLE 3	COMPARABLE 4
Address: City/State:	East Side of Ferry Street, South of 29th Ave SW Albany, OR	34th Avenue, east of Pacific Highway Albany, OR	1958-1984 Fescue Street SE Albany, OR	2500 Ferry Street SW Albany, OR
PHYSICAL INFORMATION	Allowed Use: Gross Site Size (acres): Gross Site Size (sf): Net Site Size (acres): Net Site Size (sf): Zoning: Shape: Topography: Access: Exposure: Corner: Utilities:	Industrial 1.81 78,844 1.68 73,181 IP, Industrial Park Rectangular Level Average Average to good No All	Industrial 3.12 135,821 3.12 135,821 LI, Light Industrial Rectangular Level Average to good Excellent No All	Industrial 2.10 91,476 2.10 91,476 LI, Light Industrial Rectangular Level Average Average No All
SALE INFORMATION	Transaction Date: Transaction Status: Transaction Price: Analysis Price: Rights Transferred: Price per Net SF:	3/13/2006 Recorded \$190,000 \$190,000 Fee Simple \$2.60	7/18/2001 Recorded \$476,000 \$476,000 Fee Simple \$3.50	Listing \$250,000 \$250,000 Fee Simple \$2.73
Remarks:	A rectangular industrial site located in an established industrial area in Albany. Average access, average to good exposure.	An irregularly shaped industrial site that was purchased for development of a mini-storage. The buyer approached the seller.	A rectangular industrial site that was on the market for seven months. Developed with the Parrott's furniture retail store. Excellent exposure to Interstate 5.	A generally rectangular site located in an established industrial in Albany. The site is one lot off Ferry Street and has average access and exposure. This site was listed since October 2005 and can only be sold in conjunction with or after the adjacent in conjunction with, or after an adjacent improved property sells.

LAND SALES LOCATION MAP



Data use subject to license.
 © 2005 DeLorme, Street Atlas USA © 2006.
 www.delorme.com

★
 MN (16.7° E)

0 800 1600 2400 3200 4000 ft
 Data Zoom 12-7

COST APPROACH (continued)

Considering the subject's overall location and physical characteristics, as well as the previous comparable analysis and anecdotal information, a unit value of \$2.75/SF is estimated for the subject's site, or (141,570 SF x \$2.75/SF) \$390,000, rounded.

IMPROVEMENT COST ANALYSIS

To estimate the replacement cost of the subject's improvements, we have relied on the *Marshall Valuation Service*, a national cost-estimating guide that publishes the average cost of various building types. The costs include the following: construction interest, permits, architect's and engineering fees, taxes during construction, contractor's overhead and profit, and standard tenant improvements. The costs do not include miscellaneous indirect costs, absorption costs, entrepreneurial profit and overhead, and land acquisition. The *Marshall Valuation Service Calculator Cost Method* gives average costs for typical buildings of each type, based on averages of detailed construction estimates, actual cost breakdowns, and total end costs of many actual projects. However, because each building is in some way unique, these average cost figures must be further refined.

The following base cost estimates were provided by *Marshall Valuation Service*:

- Building 1 shell has a base cost of \$19.97/SF (Low Cost Class C) and the interior office has a base cost of \$32/SF (Low/Average Cost);
- Building 2 has a base cost of \$17.21/SF (Low Cost Class S); and
- Building 3 has a base cost of \$11.68/SF (Low Cost Class C Material Storage Shed).

The following chart summarizes the subject's building improvement cost analysis.

Marshall Valuation Service				
COMPONENT	Shell	Office	Building 2	Building 3
	Building 1	Building 1		
BASE SQUARE FOOT COST	\$19.97	\$32.00	\$17.21	\$11.68
SQUARE FOOT REFINEMENTS--				
Heating, cooling, ventilation	\$1.65	\$2.25	\$1.65	\$0.00
Adjusted Square Foot Cost	\$21.62	\$34.25	\$18.86	\$11.68
HEIGHT & SIZE REFINEMENTS--				
Number of stories-multiplier	1.0000	1.0000	1.0000	1.0000
Height per story multiplier	1.0000	1.0000	1.0000	1.0000
Floor area-perimeter multiplier	1.192	1.192	1.192	1.192
Combined height & size multiplier	1.1920	1.1920	1.1920	1.1920
FINAL CALCULATIONS--				
Refined square foot cost	\$25.77	\$40.83	\$22.48	\$13.92
Current cost multiplier	1.04	1.04	1.05	1.04
Local multiplier	1.04	1.04	1.06	1.04
Final Square Foot Cost	\$27.87	\$44.16	\$25.02	\$15.06
Size (SF)	4,905	2,492	1,440	793
REPLACEMENT COST NEW (ROUNDED)	\$136,700	\$110,000	\$36,000	\$11,900
TOTAL RCN	\$294,600			

The total *Marshall Valuation Service* estimate of \$294,600 excludes costs associated with site improvements and miscellaneous indirect expenses.

COST APPROACH (continued)

- Miscellaneous indirect costs that are excluded from the direct cost estimate includes legal fees, taxes during construction, escrow fees, appraisal fees, environmental report fees, traffic impact fees, and other consulting or miscellaneous fees. This analysis estimates indirect costs at 5 percent of direct cost, or \$15,000, rounded ($\$294,600 \times 5\%$).
- Site improvements include a paved parking area (\$135,000), gravel parking (\$30,000), and perimeter fencing (\$25,000). Total site improvement costs are ($\$135,000 + \$30,000 + \$25,000$) \$190,000.

Adding these three cost components indicates a total improvement cost for the subject of ($\$294,600 + \$15,000 + \$190,000$) \$499,600, or \$69.99 per square foot of gross building area.

The concluded cost estimate includes all hard and soft costs, such as loan fees, interest during construction, professional fees, and city permits and fees. It excludes absorption costs, entrepreneurial incentive, and land acquisition.

ABSORPTION COSTS

Considering the subject's small size and owner/user appeal, no absorption costs are estimated.

ENTREPRENEURIAL INCENTIVE

Entrepreneurial incentive compensates the developer/owner for project risk and management. It is unlikely that a developer/owner would proceed with a development unless adequate profit is available to justify the effort. This cost component includes office overhead, staff, and profit. Entrepreneurial profit and overhead generally range between 5 and 20 percent of the total improvement and land cost, depending upon project size, location, and marketability. Recognizing the low interest rates, high construction costs, and generally lower profit percentage achieved for a typical owner/user building, an entrepreneurial profit/overhead of 5 percent will be utilized.

TOTAL REPLACEMENT COST NEW

Improvement costs, absorption costs, and entrepreneurial profit and overhead were analyzed in this section. Based on these individual cost estimates, total replacement cost new is estimated at \$543,600, as shown on the Cost Approach Summation Table at the end of the Cost Approach.

DEPRECIATION

From the improvement replacement cost new, a dollar amount of depreciation may be deducted. There are three types of depreciation: physical, functional, and external:

- **Physical depreciation** is the result of physical wear and tear on the improvements. Physical depreciation is divided into short-term or curable depreciation and long-term or incurable depreciation. Short-term depreciation consists of items that are

COST APPROACH (continued)

often repaired or fixed over the typical life of a building. Long-term depreciation represents general deterioration that cannot be cured without a complete structural renovation of a building.

- **Functional obsolescence** is the result of design or physical problems that reduce the income-producing ability or desirability of the subject property.
- **External obsolescence** is the result of outside influences (economic, market area) that decrease the value of the property.

All three types of depreciation have been considered. Functional obsolescence does not apply because the subject was designed with no design or physical problems. External obsolescence does not apply because the facility is located near major transportation routes in an industrial area where activity is stable.

As for physical depreciation, the average effective age of the subject is estimated to be 25 years and the economic life is approximately 40 years. Using *Marshall Valuation Service* depreciation tables, the indicated depreciation is 43%. Based on this, total physical depreciation is \$234,000.

VALUE CONCLUSION

The Cost Approach is summarized on the chart on the following page. Adding the estimated depreciated replacement cost of the subject's improvements (\$309,600) to the land value (\$390,000) indicates a market value estimated by the Cost Approach of \$699,600, rounded to:

\$700,000

Cost Approach Summation Table

Replacement Cost New--

Improvement Cost	7,138 SF x	\$69.99 /SF =	\$499,600
Developer's Overhead & Profit	5.0% x	\$889,600 =	<u>\$44,000</u>

Total Replacement Cost New = \$543,600

Less Depreciation--

Physical - Long Term	43.0%	\$234,000
Functional		\$0
Economic		<u>\$0</u>

Total Depreciation = (\$234,000)

Depreciated Replacement Cost = \$309,600

Plus Site Value \$2.75 /SF x 141,570 SF = \$390,000

Market Value (Rounded) = \$700,000

SALES COMPARISON APPROACH

The Sales Comparison Approach compares improved sales to the subject property based on an appropriate unit of comparison. Industrial properties in the subject market are typically analyzed on a price per square foot of gross building area. Therefore, this unit of comparison will be used in this analysis. When analyzing comparables, primary consideration is given to: physical characteristics such as age, construction type, condition, percentage of office area, and quality; overall building size; and location.

ADJUSTMENT TO SALE COMPARABLES

The following sales are located in the subject immediate marketplace, noting that the abutting Millersburg and Tangent locations effectively represent the same marketplace as Albany. To reflect the varying percentage of site coverage ratios, the land values for each of the comparables has been estimated¹ and deducted from their respective purchase price to indicate the contributory value of the improvements only (aka building residual value). After extracting the land, the building residual will be analyzed on a price per square foot basis. The estimated value of the building component will then be added to the previously concluded land value and thereby, indicating a total value by the sales comparison approach.

In addition to the land adjustment, the comparable sales are adjusted for atypical financing, conditions of sale, or necessary expenditures in addition to sale price when applicable. Given the lack of directly comparable improved sales, market supported quantitative adjustments are not reasonable. Rather, qualitative analysis has been conducted to determine which comparables are superior or inferior to the subject. This analysis establishes value parameters for the subject, allowing for a final conclusion of value.

PRESENTATION

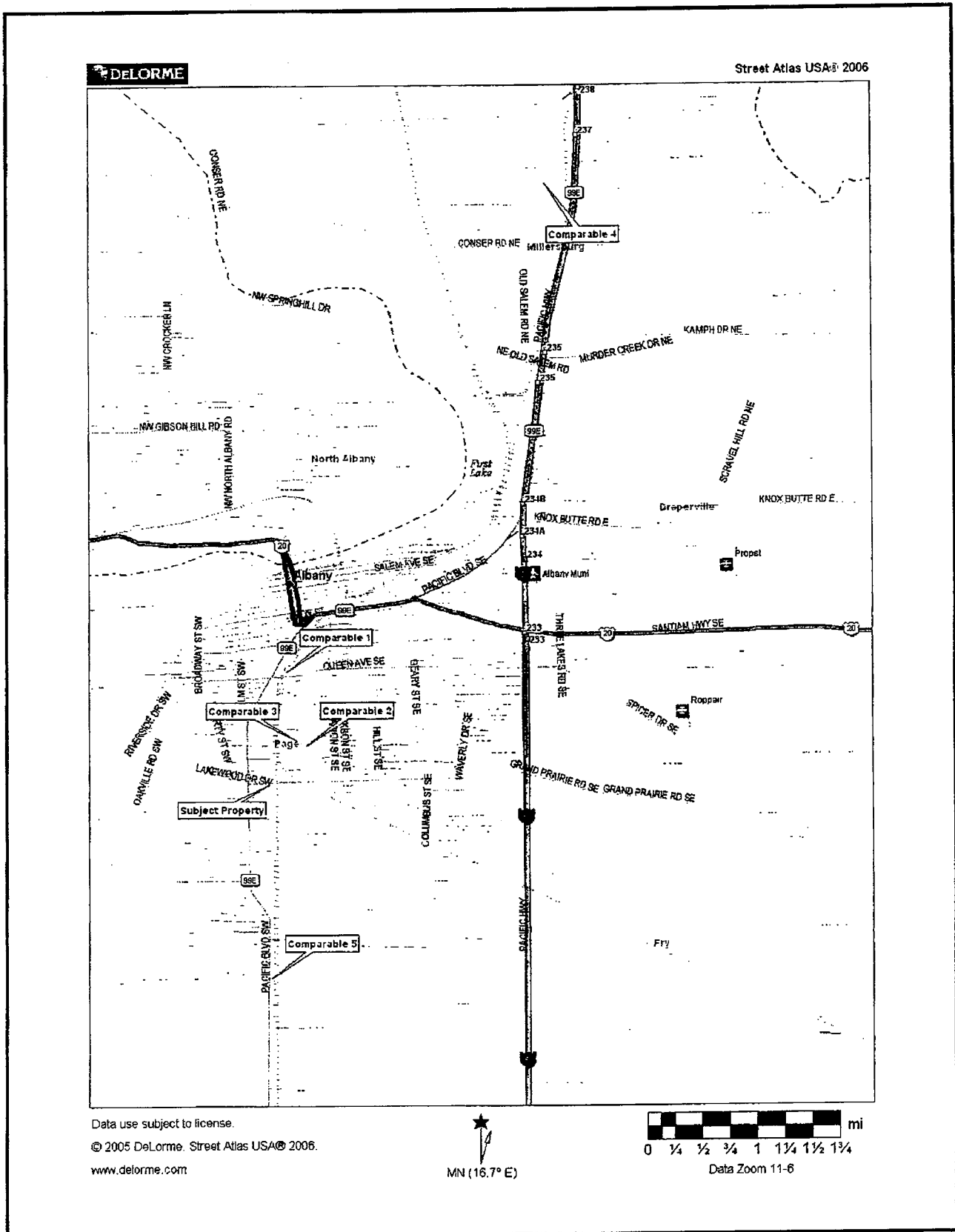
On the following pages, an Improved Sales Tabulation Chart and Improved Sales Location Map are presented, which summarize the sales used in this analysis. Photographs of each comparable are also included:

¹ Land values are estimated by comparables and estimates made by the selling brokers. The exception is Comparable 3 where the land value was estimated by the County Assessor's records.

SALE COMPARABLE TABULATION CHART

LOCATION INFORMATION	COMPARABLE 1	COMPARABLE 2	COMPARABLE 3	COMPARABLE 4	COMPARABLE 5
Property Name: Warehouse/Shop Building Address: 1624 Ferry Street SW City/State: Albany, OR County: Linn APN: T11S, R3W, Sec 7CB, TL 2500	Property Name: Light Manufacturing Building Address: 188 29th Avenue SW City/State: Albany, OR County: Linn APN: T11S, R3W, Sec 18B, TL 1013	Property Name: Manufacturing Building Address: 353 29th Avenue SW City/State: Albany, OR County: Linn APN: T11S, R3W, Sec 18B, TL 1010	Property Name: Aprtia Building Address: 353 Old Salem Road City/State: Millersburg, OR County: Linn APN: T1S-3W-30 TL 1000, RT29292	Property Name: United Pipe & Supply Address: 34403 Highway 99E City/State: Tangent, OR County: Linn APN: T1S-3W-30 TL 1000, RT29292	
Transaction Date: 7/14/2006 Transaction Status: Recorded Transaction Price: \$95,000 Analysis Price: \$105,500 Buyer paid an additional \$5,500 to hook up to city water. Analysis Price Comments: \$37,025 \$68,475 2006-17224 Fee Simple Cash to seller Arm's Length 9 Month(s)	Transaction Date: 2/28/2006 Transaction Status: Recorded Transaction Price: \$425,000 Analysis Price: \$425,000 \$148,539 \$276,462 2006-04798 Fee Simple Cash to seller Arm's Length 3 Month(s)	Transaction Date: 8/15/2005 Transaction Status: Recorded Transaction Price: \$605,000 Analysis Price: \$605,000 \$135,620 \$469,380 1749-254 Fee Simple Cash to seller Arm's Length 6 Month(s)	Transaction Date: 5/8/2005 Transaction Status: Recorded Transaction Price: \$407,000 Analysis Price: \$407,000 \$286,408 \$273,707 1709-467 Leased Fee Cash to seller Arm's Length 4 Month(s)	Transaction Date: 5/21/2003 Transaction Status: Recorded Transaction Price: \$875,000 Analysis Price: \$875,000 \$286,408 \$588,593 1428-194 Fee Simple Cash to seller	
Estimated Land Price Estimated Building Price (Residual) Recording Number: Rights Transferred: Financing: Conditions of Sale: Market Time:	0.34 14,810 L1, Light Industrial 20% Single-Tenant 3,030 3,030 1 1970s Exact date unknown Fair Fair Fair Wood frame None Grade Level Gas heat only.	1.24 54,014 L1, Light Industrial 10% Single-Tenant 5,600 5,600 1 1997 Average/Good Average/Good Good Steel 8% 1-Grade Level A 400 SF storage mezzanine is excluded from the 5,600 SF.	2.64 114,988 L1, Albany 9% Single-Tenant 10,408 10,408 1 1999 Average/Good Good Average Steel 12.40% 1-Grade Level Warehouse Heat, AC in Office Size excludes 1,287 SF of mezz. storage. There is no excess land as the building is on the usable portion of the site.	2.63 114,563 15% Single-Tenant 17,300 17,300 1 1975 Average Average Average Steel 13.20% 6-Dock high & Grade Level	
PHYSICAL INFORMATION Site Size (acres): Site Size (sf): Zoning: Project Type: Gross Building Area (sf): Leasable Area (sf): No. of Buildings: Year Built: Quality: Condition: Appeal: Construction Type: % of Office Build-out: Loading Doors: HVAC: Physical Comments:	N/A N/A \$34.82 \$23	N/A N/A \$75.89 \$49	N/A N/A \$58.13 \$45	N/A N/A \$50.58 \$34	
ANALYSIS INFORMATION NOI: Cap Rate: Price/SF (Overall): Building Only Value/SF (Excludes Land)	N/A N/A \$34.82 \$23	N/A N/A \$75.89 \$49	N/A N/A \$58.13 \$45	N/A N/A \$50.58 \$34	
CONFIRMATION INFORMATION Contact: Company:	Rob Richards Coldwell Banker - Albany	Jim O'Bryant HCS Commercial	Curt Arthur Coldwell Banker Commercial	Bill MacHugh Investment Realty, Inc.	Jim O'Bryant HCS Commercial
Remarks:	Originally a cabinet shop that was used by the seller for warehousing. The buyer plans to renovate the building to office/warehouse. The yard area is gravelled; there is no office space. The broker estimated the land value at \$2.50/SF, or \$37,025.	This is a steel framed building with metal clad siding. There is surplus land that will be used in the near term by the buyer for storage. The broker reported that all land area contributed the same value (estimated at \$3/SF). A small wetland area (50x50) also contributed full value.	A manufacturing building that will be owner occupied by Tak-Fab. Located in an industrial district in the City of Albany. The office interior was reported to be in good condition and quality. (C051001-38)	Located in Millersburg, a small community along the Interstate 5 corridor and adjacent to the City of Albany. Located in an industrial district with nearby access to I-5. The tenant plans to renew their lease. The tenant (Aprtia) is a national tenant. (C051001-39)	Steel frame, metal sided building with excellent exposure to Highway 99E. Purchased for owner occupancy by United Pipe & Supply. (C040567-72)

IMPROVED SALES LOCATION MAP



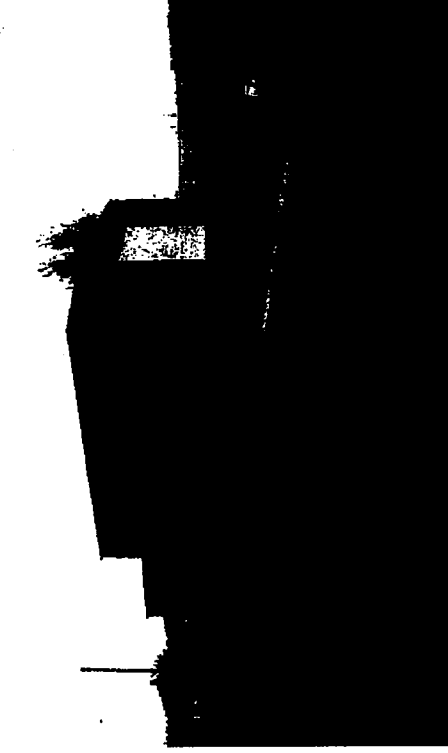
IMPROVED SALES PHOTOGRAPHS



Comparable 1. (C061164-29)



Comparable 3. (C051001-38)



Comparable 2. (C061164-16)



Comparable 4. (C051001-39)

IMPROVED SALES PHOTOGRAPHS (continued)



Comparable 5. (C040567-72)

SALES COMPARISON APPROACH (continued)

DIRECT COMPARABLE ANALYSIS

The comparables range from \$23 to \$49 per square foot (building only value). The comparables bracket the subject well in terms of overall size, construction type, and overall appeal.

Comparable 1 (\$23/SF - adjusted) sets the low end of the range. This comparable is an inferior quality industrial shop building due to its wood frame construction, no office space, and no site improvements. The condition of the building is also inferior. It is a low indicator of value.

Comparable 2 (\$49/SF - adjusted) and **Comparable 3 (\$45/SF - adjusted)** represent the upper end of the range. They are both near the subject with similar locational features. They are both newer buildings that are in superior overall construction. Also, the interior condition of the office space, as well as its quality, is superior. These two comparables are high indicators of value.

Comparable 4 (\$44/SF - adjusted) is similar to the subject with respect to its concrete block construction and small size. The building is newer and its condition is superior. Also, the interior condition and quality of the office space is superior. It too is a high indicator of value.

Comparable 5 (\$34/SF - adjusted) is over twice the size as the subject, which puts some downward pressure on unit value. This comparable has similar condition and quality as the subject; however, the generally utility for industrial use is slightly superior (better clear heights throughout). Overall, it is a reasonable indicator of value.

Considering the preceding comparable analysis, a building only value of \$35/SF is estimated. Each of the comparables represents fully enclosed improvements, with no three sided buildings (like the subject's Building 3). Therefore, this value estimate will be applied to Building 1 and 2 (4,905 SF + 1,440 SF = 6,345 SF), which indicates a building value of (\$35/SF x 6,345 SF) \$222,000, rounded.

Regarding the three sided building (793 SF), due to the absence of similar sales, the value contribution of this building will be estimated using depreciated replacement cost analysis. As presented in the cost approach section, the estimated depreciated replacement cost of this structure is approximately \$7,000 [(\$11,900 RCN x 1.05 Profit) - 43% depreciation].

The total estimated value of the three structures is (\$222,000 + \$7,000) \$229,000. Adding this figure to the previously estimated land value of \$390,000 indicates a total "as is" fee simple value of \$619,000, rounded to:

\$620,000

ANALYSIS OF VALUE CONCLUSIONS

The Analysis of Value Conclusions is the final step in the appraisal process and involves the weighing of the individual valuation techniques in relationship to their substantiation by market data, and the reliability of each valuation technique to the subject.

INDICATED VALUES

Cost Approach:	\$700,000
Income Capitalization Approach:	Not Presented
Sales Comparison Approach:	\$620,000

For properties with very low site coverage ratios where much of the value lies in the land component, the **Cost Approach** is a good indicator of value. While, our land value estimate is considered reliable, the limiting factor of this approach exists when estimating depreciation. Buyers of owner/user properties with low site coverage would typically consider this approach when making a purchase decision. Overall, significant emphasis is placed on this approach in the final analysis.

The **Income Capitalization Approach** was not presented as described earlier.

The **Sales Comparison Approach** included five comparable sales from which to derive a value estimate for the subject's improvements. Although this approach is the best indicator of value, it is believed that some of the value associated with excess site improvements was not fully realized in our estimate. Primary emphasis is placed on this approach.

Based on the previous discussion, the final conclusion of the "as is" fee simple market value, as of November 1, 2006, is:

\$650,000

CERTIFICATION OF APPRAISAL

We certify that, to the best of our knowledge and belief:

- The statements of fact contained in this report are true and correct.
- The reported analyses, opinions, and conclusions are limited only by the reported assumptions and limiting conditions, and are our personal, impartial, and unbiased professional analyses, opinions, and conclusions.
- We have no present or prospective interest in the property that is the subject of this report, and no personal interest with respect to the parties involved.
- We have no bias with respect to the property that is the subject of this report or to the parties involved with this assignment.
- Our engagement in this assignment was not contingent upon developing or reporting predetermined results.
- Our compensation for completing this assignment is not contingent upon the development or reporting of a predetermined value or direction in value that favors the cause of the client, the amount of the value opinion, the attainment of a stipulated result, or the occurrence of a subsequent event directly related to the intended use of this appraisal.
- The reported analyses, opinions, and conclusions were developed, and this report has been prepared, in conformity with the requirements of the *Code of Professional Ethics and Standards of Professional Appraisal Practice* of the Appraisal Institute, which include the *Uniform Standards of Professional Appraisal Practice*.
- I, Daniel R. Orman, have made a personal inspection of the interior and exterior of the property that is the subject of this report and have inspected the exterior of all the comparables.
- I, Donald R. Palmer, MAI, have not made a personal inspection of the property that is the subject of this report or the comparables, I have thoroughly reviewed the analysis procedures and valuation presented herein and concur with the contents of this report.
- No one provided significant real property appraisal assistance to the persons signing this certification.
- The use of this report is subject to the requirements of the Appraisal Institute relating to review by its duly authorized representatives.

As of the date of this report, I, Donald R. Palmer, MAI, have completed the continuing education program of the Appraisal Institute.

Daniel R. Orman ^{SOA}
Daniel R. Orman
OR State Certified General Appraiser
No. C000179

11/13/06
Date

Donald R. Palmer ^{MAI}
Donald R. Palmer, MAI
OR State Certified General Appraiser
No. C000060

11/13/06
Date

ADDENDA

QUALIFICATIONS OF PGP VALUATION INC

PGP VALUATION INC

QUALIFICATIONS

PGP VALUATION INC was established in 1978 as a partnership, and incorporated in 1993. Our primary goal is to serve our clients in an effective and timely manner by preparing appraisal and feasibility reports which can be relied upon for decision-making purposes by our clients. Our reports utilize current analytical tools and recognized appraisal methods. The members of our firm adhere to the Code of Ethics established by the Appraisal Institute, and strive to maintain a high level of professional integrity. Services are provided throughout the United States with local offices in Portland, Oregon; Sacramento and San Diego, California; Seattle and Vancouver, Washington.

PROFESSIONAL SERVICES

Our firm offers a wide range of services in the evaluation of real estate:

- | | |
|--------------------------------|--|
| Real Estate Appraisals: | Valuation estimates on all type of properties including residential, commercial, and industrial. |
| Market Research: | Market analysis and feasibility studies of all property types. Additional services include fiscal and socio-economic impact assessment; benefit-cost analysis; forecasting and modeling; public need assessment, site evaluation; highest and best use analysis; questionnaires and surveys. |
| Consultation: | Analysis of real estate regarding values, site development potential, market standard versus competitive edge amenities, market conditions, et cetera. |
| Court Testimony: | Professional opinions as expert witnesses regarding the valuation of real estate. |
| Property Tax Analysis: | Representation before government agencies regarding ad valorem taxes, including preliminary value consultation, appraisals, Board of Equalization and Tax Court presentations. |

IMPORTANT ASSIGNMENTS AND REFERENCES

PGP VALUATION INC provides appraisals on all property types (multiple family, industrial, retail, office, and special purpose properties), and we serve lenders, government agencies, attorneys, corporations, and investors. Please contact us for references.

PGP VALUATION INC

LOCATIONS

PORTLAND OFFICE

110 SW Yamhill Street, Suite 200
Portland, Oregon 97204-3024
Telephone: (503) 226-0983
FAX: (503) 273-4273
E-Mail: portland@pgppdx.com

SACRAMENTO OFFICE

3815 Marconi Avenue, Suite 1
Sacramento, California 95821-3866
Telephone: (916) 481-0620
FAX: (916) 481-0630
E-Mail: sacramento@pgpinc.com

SEATTLE OFFICE

1325 4th Avenue, Suite 500
Seattle, Washington 98101-2517
Telephone: (206) 343-7477
FAX: (206) 682-7207
E-Mail: seattle@pgpinc.com

SAN DIEGO OFFICE

550 Laguna Drive, Suite A
Carlsbad, California 92008-1698
Telephone: (760) 720-2525
FAX: (760) 730-3372
E-Mail: sandiego@pgpinc.com

VANCOUVER OFFICE

112 W. 11th Street, Suite 250
Vancouver, Washington 98660-3143
Telephone: (360) 699-4844
Longview: (360) 425-3153
Oregon: (503) 285-0519
FAX: (360) 699-1904
E-Mail: vancouver@pgpinc.com

PROFESSIONAL STAFF

PORTLAND, OREGON

Market Feasibility

John D. Ingle

Commercial

Donald R. Palmer, MAI
Brian L. Kelley, MAI
Todd S. Liebow, MAI
Nathaniel V. Bockmann
George H. Bushnell, Jr.
Matthew P. Call
Bryan W. Chase
Jason K. Chin
Gerald E. Duce
Sally B. Eddy
Terry A. Gardner, MAI, SRA
A. Brett Gresham
Jeff L. Grose
Devin J. Henery
Joel K. Jorgensen
Rob K. Klever
Cody F. Knox
Luke B. Leahy
James E. Lingeman
Matt H. Logan
Michael J. Mangan
Brian A. Meyer
Roger J. Mitchell
W. Grant Norling
Daniel R. Orman
David E. Pietka, MAI
Bronson W. Rueda
Jeremy A. Snow
Karen J. Storm
Michael B. Thelin
Thomas A. Tillisch
William A. Toelke
Eric (Rick) J. Walker, AICP
Daniel K. Young

Residential Affiliate

Mark H. Hepner
Steven J. Gentzkow, MAI

SEATTLE, WASHINGTON

Commercial

Christopher K. Monger, MAI
Philip L. Steffen, MAI
Matt Albee
John Bryan
Lisa Carter
Suzanne Coleman
Joe Creech
Ronan Edmonson
Reid C. Erickson
James Gibson
Bella Hopkinson
Prithy Karathu
Cheryl L. Lotz
Jocelyn Markey
Stan Mastalerz
Matthew Plewe
Colin F. P. Radford
Michael Rice
Reneé C. Schaefer
Brennen Stoknes
Patrick Taylor
Ben Wilcox

Property Tax Consulting

John A. Campbell

VANCOUVER, WASHINGTON

Commercial

David W. Groth, MAI
Mark M. Lawwill, MAI
Owen Bartels
Matt Dodd
Dean M. Meyer, MAI
Steven Redmond
Tara Schultz
Kathryn Skiff
Leslie Waltz
Steven Waugh
Eric Warner
Lacey Westlake

Residential

D. Josh Fry
Mark R. Davis
Heidi Sowards

SACRAMENTO, CALIFORNIA

Finance

Cheryl Mandich

Commercial

Timothy E. Wright, MAI
Christoff C. Vaterlaus, MAI
Brandon Bowthorpe
Rob Detling
Steven D. Dunn, MAI, SRA
Ryan Fletcher
Jonathan Fletcher
James A. Fogelberg
David Gull
Gabe Hill
R. Todd Larsen
John Larson
Bruce MacMaster
Bracken Mannion
Gavin McPhie
David Newman
Kenny Pratt
Marty Shearer
Jeff Shouse
Scott Shouse
Robert Steed
Richard Walcott

SAN DIEGO, CALIFORNIA

Commercial

Kenneth R. Harrison, MAI
Gary Berntsen
Frank Harrison
Bobby Hastings
John Holmstrom
Rebecca Horvat
Randy King
Jared Mathews
Russell McCoy
Matthew Reynolds
Kevin Ritter
Shoeyb Yousofy

PGP VALUATION INC

CLIENTS

Portland Office

ATTORNEYS

Ater Wynne LLP
Ball Janik LLP
Black Helterline LLP
Brownstein, Rask, Arenz, et al
Bullivant Houser Bailey
Carney, Buckley, Kasameyer & Hays
Copeland, Landye, Bennett & Wolf LLP
Davis Wright Tremaine
Dunn Carney Allen Higgins & Tongue
Foster Pepper & Sheffelman, LLP
Garvey, Schubert & Barer
Gevurtz Menashe
Lane Powell, LLP
Miller, Nash, Weiner, Hager & Carlsen LLP
Preston Gates & Ellis LLP
Perkins Coie LLP
Stahanczyk Gearing Rackner and Kent, PC
Stoel Rives, LLP
Sussman Shank Caplan Wapnick & Stiles LLP
Tonkon Torp LLP
Williams Fredrickson & Stark LLP

CONSULTANTS

CIDA, Inc.
David Evans & Associates
Geller, Silvis & Associates
Shiels Obliet Johnson LLC
W&H Pacific
WRG Design Inc.

CORPORATIONS

Cascade General
City Center Parking
Epson Portland
Goodwill Industries
IBM Corp.
Intel Corporation
Kaiser Permanente
Legacy Health System
Louisiana Pacific
McDonald's Corporation
Nike, Inc.
Northwest Natural
Portland General Electric
Providence Health System
Standard Insurance
Sulzor Pumps (US) Inc.
Texaco Marketing Co.
Tosco Marketing Co.
Union Pacific Railroad

DEVELOPERS/OWNERS

Andersen Construction Company
Archstone-Smith Communities
ASA Properties
Bean Investment Real Estate
Birtcher Properties
Brian McCarl & Co.
Burnham Pacific
C.E. John Company, Inc.

Equity Residential
Gramor Oregon, Inc.,
Guardian Management Corporation
H. Naito Properties
Harsch Investment Corp.
James Property Investments
Koll Development Group
Louis Dreyfus Property Group
McMenamins
Melvin Mark Companies
National Retail Partners
North Pacific Management
Octagon Development Co.
Pacific Realty Associates, L.P.
PanPacific Realty
Principal Capital Management
Schnitzer Investment Corp.
The Specht Company
Three Oaks Development
TN Development
Trammell Crow Company
Watumull Properties
West Hills Development Co.
WinCo Foods
Winkler Development Corp.

GOVERNMENT/INSTITUTIONAL

City of Canby
City of Hillsboro
City of Lake Oswego
City of McMinnville
City of Milwaukie
City of Portland
City of West Linn
City of Wilsonville
Clackamas County
Clatskanie School District
Housing Authority of Portland (HAP)
Lewis & Clark College
Metro
Multnomah County
North Clackamas School District
Oregon Department of Revenue
Oregon Department of State Lands
Oregon Health Sciences University
Oregon Housing & Community Services
Oregon State University
Port of Hood River
Port of Portland
Port of St. Helens
Portland Development Commission
Portland Public Schools
Portland State University
State of Oregon
The Nature Conservancy
The Trust for Public Lands
The Waldorf School
U.S. Fish & Wildlife
U.S. Marshals Service
Washington County
Washington Department of Revenue
Yamhill County

LENDERS

AEGON USA Realty Advisors, Inc.
Albina Community Bank
Bank of Astoria
Bank One Corporation
Bank of America
Bank of the West
Centennial Bank
Clackamas County Bank
Continental Savings Bank
Finova Realty Capital Inc.
First Security Bank
GE Capital Corp.
Green Park Financial
Holliday, Fenoglio, Fowler, L.P.
Interwest Mortgage Investment
JP Morgan Capital Terrace
Key Bank National Association
LJ Melody
Manufacturers and Traders Trust Company
M&T Bank
Merchants Bank
Midland Loan Services
National Mortgage Co.
New York Life Insurance Co.
Norris Beggs & Simpson
Oregon Business Bank
Pacific Continental Bank
Pacific NW Bank
Prudential Mortgage Capital
St. Helens Community Federal Credit Union
Seattle Mortgage
Shore Bank Pacific
Sterling Savings Bank
U.S. Bank
Washington Federal
Washington Mutual Bank
Wells Fargo Bank
West Coast Bank
West Coast Mortgage

NON-PROFIT

Affordable Community Environments
Central City Concern
Network for Oregon Affordable Housing
(NOAH)
Reach Community Development
Specialized Housing Inc.

OTHER

Archdiocese of Portland
ASB Capital Management, Inc.
Church of the Nazarene
Cushman & Wakefield of Oregon
Ernst & Young LLP
First American Title Insurance
GE Capital Investment Advisors
Grubb & Ellis Company
KPMG, LLP
Moss Adams LLP
NW General Presbyterian
Rubicon International
Seventh-Day Adventist Church
Sisters of the Holy Names

QUALIFICATIONS OF APPRAISERS

Qualifications of
DANIEL R. ORMAN
Commercial Appraiser

Dan Orman has been an appraiser with PGP VALUATION INC since 1988. His specialties include retail, office, and industrial properties. Dan is married, has three children, and resides in Corvallis.

PROFESSIONAL EDUCATION

Oregon State University ♦ Corvallis, Oregon ♦ 1985
Bachelor of Science Degree ♦ Health Care Administration

APPRAISAL INSTITUTE COURSES

Real Estate Appraisal Principles
Basic Valuation Procedures
Capitalization Theory and Techniques A & B
Standards of Professional Practice
Case Studies
Report Writing
Condemnation Appraising
Partial Interest Valuation
Highest & Best Use and Market Analysis

REAL ESTATE EXPERIENCE

PGP VALUATION INC ♦ Portland, Oregon
Commercial Appraiser ♦ 1988 to Present
City of Portland ♦ Portland, Oregon
Real Property Technician

LICENSE AND CERTIFICATION

Certified General Real Estate Appraiser ♦ State of Oregon
Certificate No. C000179

Qualifications of
DONALD R. PALMER, MAI
Principal

Don Palmer was born in Sunnyside, Washington in 1948. Don spent his early years in the lower Yakima Valley, graduating from Washington State University in 1970 with a Bachelor of Arts in Business Administration. Since graduating, he has resided in Portland, Oregon, and has been active in the Appraisal Institute, the Oregon Mortgage Bankers Association, the Portland Metro Building Owner's Association, Multnomah Athletic Club, and Tualatin Country Club.

PROFESSIONAL EDUCATION

Washington State University ♦ 1970
Bachelor of Arts Degree ♦ Business Administration

CONTINUING EDUCATION

<u>Course</u>	<u>Date</u>	<u>Sponsor</u>
Eminent Domain	04/2005	The Seminar Group
USPAP	09/2005	Appraisal Institute
Non-USPAP Appraiser Regulatory	07/2004	Bob Keith Appraiser Seminar
USPAP	09/2004	Appraisal Institute
Land Valuation Adjustment	09/2004	Appraisal Institute
The Road Less Traveled	09/2004	Appraisal Institute

GUEST LECTURER

Washington Eminent Domain Conference ♦ 2005
Oregon Eminent Domain Conference ♦ 2005

REAL ESTATE EXPERIENCE

Principal ♦ PGP VALUATION INC (formerly Palmer, Groth & Pietka, Inc.)
Real Estate Appraiser ♦ Curtis & MacKenzie
Appraiser ♦ Assessor's Office, Multnomah County, Oregon

LICENSE AND CERTIFICATION

Certified General Real Estate Appraiser ♦ State of Oregon
Certificate No. C000060
Certified General Real Estate Appraiser ♦ State of Washington
License No. 27011 1100446

PROFESSIONAL AFFILIATIONS

Appraisal Institute
Oregon Mortgage Bankers Association

PGP VALUATION INC

Qualifications of Donald R. Palmer, MAI (continued)

PROFESSIONAL DESIGNATIONS

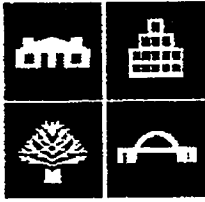
MAI ♦ Appraisal Institute

COMMUNITY SERVICES

Board of Directors, 1983-1984 - Athletic Association, Portland State University
Board of Directors, 1985-1986 - Parry Center
Board of Directors, 1987-1990 - Appraisal Institute
President, 1989 - Appraisal Institute
Board of Directors, 1988-1989 - Oregon Mortgage Bankers Association
Real Estate Advisory Committee - Boy Scouts of America
Board of Directors, 1987-1990 - Portland Metro Buildings & Owners Association
Board of Directors, 1990-1991 - State of Oregon, Real Estate Agency
President, 1992 - Portland Metro Buildings, Owners, & Managers Association
Cathedral School Board, 1991-1992
Board of Directors, President, Vice President, Treasurer, 1995 to 2001 - Tualatin Country Club
SW Community Center Task Force, 1998 - City of Portland
Washington State University Planned Giving Advisory Board, 2002-Present
St. Mary's Auction Chairperson, 2002

COMMUNITY AWARDS

Portland Metro Builders & Owners Association
Member of the Year, 1985



PGP VALUATION INC

REAL ESTATE APPRAISERS & CONSULTANTS
110 SW YAMHILL • SUITE 200 • PORTLAND OREGON 97204
503.226.0983 • PHONE • www.pgpinc.com • FAX • 503.273.4273

FOR SERVICES RENDERED — PLEASE REFER TO JOB NUMBER WHEN REMITTING — THANK YOU

INVOICE

Steven A. Walti
Supervisor Risk Envir. & Land
NW Natural Gas
220 NW 2nd Avenue
Portland, Oregon 97209

Job No. C061164
November 13, 2006
Federal Tax ID #93-1114929

SUMMARY APPRAISAL REPORT

NW Natural Service Center
730 W 34th Avenue
Albany, Oregon

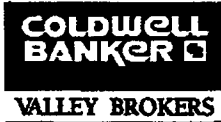
Professional Fee
Total Due

\$4,000.00
\$4,000.00

Payment is due upon receipt. A service fee of 1.5% per month will be charged on all accounts in excess of 30 days past due.

APPROVED FOR PAYMENT				
APPROVED <i>Andr. K. Hart</i>				
APPROVED _____				
Vendor # _____		Box _____		
Mail Code _____		Date Due <u>11/14/06</u>		
Mail	Acct	City	State	Amount
51020	5024	925	1505	\$4,000.00

Recd Payment
11/27/06



2225 Pacific Blvd. SE - Suite 101
Albany, OR 97321
Ph. (541) 928-6317
Fax (541) 928-0223

April 18, 2007

Steve Walti
Risk Environment & Land Supervisor
Northwest Natural Gas Co.
220 NW Second Avenue
Portland, OR 97209

Subject: **Market Analysis - 730 34th Ave. SW - Albany, OR**

Dear Mr. Walti:

As we discussed I have performed a Comparable Market Analysis on the Northwest Natural Gas property located at 730 34th Ave. SW in Albany Oregon. This property was formally used for the Gas Company's service operation. The property has a service building (see floor plan) and also out building(s). The property includes 3.27 acres and is totally enclosed with cyclone/security fencing. The zoning is currently HI - Heavy Industrial.

Opinion of Value: As with many commercial properties, their uniqueness makes the availability of comparable sales difficult to find. We have included 9 comparable properties for your review. The properties statuses are a combination of Active, Pending and Sold.

- Prices of properties ranged from \$425,000 to \$800,000
- Size of Land ranged from 1 to 4 acres
- Days on the Market ranged from 96 to 516

Using this market data, and factoring in the value of the improvements our recommendation would be to use an initial list price at \$705,000 to \$725,000. ***This is an opinion only and does not replace a professional appraisal.*** If you have any questions please give us a call at (541) 928-6317.

Regards,

Bill Ekman Rob Richards Ana Norlander

Bill Ekman, Rob Richards & Ana Norlander - Broker(s)

Note: There appears to be underground storage tanks still located on the premises. The condition and status of these tanks will impact the value and ability to market this property.

This Market Analysis is an opinion only and does not replace a professional appraisal. Information used in this analysis was taken from Public Tax Records and/or the Willamette Valley Multiple Listing Service. This information is deemed reliable, but not guaranteed.

Each Coldwell Banker Office is Independently Owned & Operated

Exhibit D

Copies of all contracts related to the sale of the Property

- Purchase and Sale Agreement and Receipt for Earnest Money, dated as of April 8, 2008, between Northwest Natural Gas Company and Elwood Martin and/or assigns.
- Promissory Note (for Earnest Money) from Elwood Martin, dated as of April 8, 2008, in the amount of \$10,000.
- Addendum to Purchase and Sale Agreement and Receipt for Earnest Money, dated as of May 16, 2008, between Elwood Martin and Northwest Natural Gas Company.
- Addendum to Purchase and Sale Agreement, dated as of June 3, 2008, between Elwood Martin and Northwest Natural Gas Company.

**PURCHASE AND SALE AGREEMENT AND RECEIPT FOR
EARNEST MONEY**

1 Dated: April 8, 2008

2
3 BETWEEN:

4 Northwest Natural Gas Company ("Seller")

5 Address:

6

7

8 AND:

9 Elwood Martin and/or assigns ("Buyer")

10 Address:

11

12

13 Buyer offers to buy and acquire from Seller (i) the real property and all improvements thereon
14 commonly known as NW Natural Gas Building and Land and located at 730 SW 34th
15 Avenue, in the City of Albany, County of Linn, Oregon legally described as follows: Tax
16 Accnt: R381398 Tax Lot: #101, Ref Parcel # 11S-4W-13-SE-SE, consisting of
17 approximately 3.25 +/- acres and all improvements thereon, actual legal description to be
18 provided by First American Title Company and approved by the Buyer and Seller prior to
19 escrow and attached hereto and incorporated herein by reference (the "Property"). If no legal
20 description is attached, Buyer and Seller will attach a legal description upon receipt and
21 reasonable approval by both parties of the Preliminary Commitment or, if applicable, the
22 Survey.

23

24 **1. Purchase Price.** The total purchase price is Seven Hundred and Ten
25 Thousand Dollars---(\$710,000.00) (the "Purchase Price") payable as follows: All Cash at
26 Close of Escrow.

27

28 **2. Earnest Money Deposit.** Upon execution of this Agreement, Buyer shall
29 deliver to the Escrow Holder as defined in herein, for the account of Buyer \$10,000.00 as
30 earnest money (the "Earnest Money") in the form of cash or check or promissory
31 note (the "Note"). If the Earnest Money is in the form of the Note, it shall be due and payable
32 no later than 5 PM Pacific Time by Buyer and Seller or One day after waiver of all
33 conditions stipulated to Buyer's obligation to purchase the Property set forth in this
34 Agreement.

35 If the Note is not redeemed and paid in full when due, then (i) the Note shall be delivered and
36 endorsed to Seller (if not already in Seller's possession), (ii) Seller may collect the Earnest
37 Money from Buyer, either pursuant to an action on the Note or an action on this Agreement,
38 and (iii) Seller shall have no further obligations under this Agreement. The purchase and sale
39 of the Property shall be accomplished through an escrow (the "Escrow") which Seller has
40 established or will establish with First American Title Company, (the "Title Company") and
41 the Earnest Money shall be deposited with Title Company located at the following branch:
42 1124 Cornucopia St N.W., Salem, OR 97304 Attn: Debbie Smith, Commercial Escrow
43 Officer. The Earnest Money shall be applied to the payment of the purchase price for the

44 Property at Closing. Any interest earned on the Earnest Money shall be considered to be part
45 of the Earnest Money. The Earnest Money shall be returned to Buyer in the event any
46 condition to Buyer's obligation to purchase the Property shall fail to be satisfied or waived
47 through no fault of Buyer.

48 3. Conditions to Purchase. Buyer's obligation to purchase the Property is
49 conditioned on the following: Buyer's approval of the results of (i) the Property inspection
50 described in Section 4 below and (ii) the document review described in Section 5 and (iii)
51 Buyers satisfaction and/or waiver of the following:

52
53 A) Tax deferred exchange
54 Both Buyer and Seller may participate in a 1031 Tax Exchange at their own
55 expense; said Exchange shall not hinder or delay the completion of this
56 transaction.

57
58 B) Finance contingency
59 Buyer is financing a portion of the purchase of this property. This transaction
60 is contingent upon the Buyer receiving lender financing at terms and conditions
61 acceptable to the Buyer within forty five (45) days of Execution Date of this
62 Agreement. If the Buyer has not given written approval of all other terms and
63 conditions related to financing within forty five (45) days after Execution Date
64 of this Agreement, Buyer may elect to terminate this Agreement with both Buyer
65 and Seller having no further obligation to each other, and any amount or form
66 of earnest monies shall be promptly returned to the Buyer.

67
68 C) Buyers Feasibility - Due Diligence contingency
69 Buyer shall have forty five (45) days from Execution Date to perform any due-
70 diligence and feasibility investigations deemed necessary for the Buyer's
71 intended use and future development of the subject property. If for any reason
72 the Buyer has not given written approval of this due diligence feasibility period
73 within forty five (45) days of Execution Date of this Agreement, this Agreement
74 may be terminated at the Buyers discretion, with the Buyer and Seller having no
75 further obligation to each other, and any amount or form of earnest monies
76 shall be immediately returned to the Buyer.

77
78 D) Buyer Inspections
79 This transaction shall be conditioned on the Buyer's property inspection period
80 as stipulated in section 4 below. The Buyer shall have forty five (45) days from
81 Execution Date to perform any and all inspections deemed necessary, including
82 all levels of Environmental studies.
83 If for any reason the Buyer has not given written approval of the inspection
84 period within forty five (45) days after Execution Date of this Agreement, this
85 Agreement may be terminated at the Buyers discretion, with the Buyer and
86 Seller having no further obligation to each other, and any amount or form of
87 earnest monies shall be immediately returned to the Buyer. Any inspections or
88 studies performed on the subject property shall be completed at the Buyer's
89 own expense.
90

© 1997 Commercial Association of REALTORS © OREGON/SW WASHINGTON (Rev. 11/03) Buyer Initials: EM
PURCHASE AND SALE AGREEMENT AND RECEIPT FOR EARNEST MONEY (OREGON)

Sellers Initials: MLA

91 if for any reason in Buyer's sole discretion, Buyer has not given written waiver of
92 these conditions, or stated in writing that these conditions have been satisfied, by
93 written notice given to Seller within 45 days after the delivery of a fully executed
94 Agreement to Buyer and Seller, this Agreement shall be deemed automatically
95 terminated, the Earnest Money shall be promptly returned to Buyer, and thereafter,
96 except as specifically provided to the contrary herein, neither party shall have any
97 further right or remedy hereunder.
98

99 4. **Property Inspection.** Seller shall permit Buyer and its agents, at Buyer's
100 sole expense and risk, to enter the Property at reasonable times after reasonable prior
101 notice to Seller and after prior notice to the tenants of the Property as required by the
102 tenants' leases, if any, to conduct any and all inspections, tests, and surveys concerning the
103 structural condition of the improvements, all mechanical, electrical and plumbing systems,
104 hazardous materials, pest infestation, soils conditions, wetlands, Americans with Disabilities
105 Act compliance, and all other matters affecting the suitability of the Property for Buyer's
106 intended use and/or otherwise reasonably related to the purchase of the Property including
107 the economic feasibility of such purchase. Buyer shall indemnify, hold harmless, and defend
108 Seller from all liens, costs, and expenses, including reasonable attorneys' fees and experts'
109 fees, arising from or relating to Buyer's entry on and inspection of the Property. This
110 agreement to indemnify, hold harmless, and defend Seller shall survive closing or any
111 termination of this Agreement.
112

113 5. **Seller's Documents.** Within 10 days after the Execution Date, Seller shall
114 deliver to Buyer, at Buyer's address shown above, legible and complete copies of
115 the following documents and other items relating to the ownership, operation, and
116 maintenance of the Property, to the extent now in existence and to the extent such items are
117 within Seller's possession or control: include any documents pertaining to property;
118 copies of any active leases or rental agreements; list any upgrades performed on the
119 property within the last three years; provide any documents, plans, drawings, or
120 specifications of the structures and real property; any maintenance agreements; all
121 environmental studies performed of any kind, any notices or correspondence from City,
122 State, County, or other governmental authorities about the subject property that could
123 affect the future use or condition of the property.
124

125 6. **Title Insurance.** Within 10 days after the Execution Date, Seller shall open the
126 Escrow with the Title Company and deliver to Buyer a preliminary title report from the Title
127 Company (the "Preliminary Commitment"), showing the status of Seller's title to the Property,
128 together with complete and legible copies of all documents shown therein as exceptions to
129 title ("Exceptions"). Buyer shall have 10 days after receipt of a copy of the Preliminary
130 Commitment and Exceptions within which to give notice in writing to Seller of any objection to
131 such title or to any liens or encumbrances affecting the Property. Within 10 days after the
132 date of such notice from Buyer, Seller shall give Buyer written notice of whether it is willing
133 and able to remove the objected-to Exceptions. Within 10 days after the date of such notice
134 from Seller, Buyer shall elect whether to (i) purchase the Property subject to those objected-
135 to Exceptions which Seller is not willing or able to remove or (ii) terminate this Agreement.
136 On or before the Closing Date (defined below), Seller shall remove all Exceptions to which
137 Buyer objects and which Seller agrees Seller is willing and able to remove. All remaining

138 Exceptions set forth in the Preliminary Commitment and agreed to by Buyer shall be deemed
139 "Permitted Exceptions." The title insurance policy to be delivered by Seller to Buyer
140 at Closing shall contain no Exceptions other than the Permitted Exceptions, any Exceptions
141 caused by Buyer and the usual preprinted Exceptions contained in an owner's standard ALTA
142 form title insurance policy.
143

144 **7. Default; Remedies.** Notwithstanding anything to the contrary contained in this
145 Agreement, in the event Buyer fails to deposit the Earnest Money Deposit in Escrow strictly as
146 and when contemplated under Section 2 above, Seller shall have the right at any time
147 thereafter to terminate this Agreement and all further rights and obligations hereunder by
148 giving written notice thereof to Buyer. If the conditions, if any, to Buyer's obligation to
149 consummate this transaction are satisfied or waived by Buyer and Buyer nevertheless fails,
150 through no fault of Seller, to close the purchase of the Property, Seller's sole remedy
151 shall be to retain the Earnest Money paid by Buyer. In the event Seller fails, through
152 no fault of Buyer, to close the sale of the Property, Buyer shall be entitled to pursue
153 any remedies available at law or in equity, including without limitation, the remedy of
154 specific performance. In no event shall Buyer be entitled to punitive or consequential
155 damages, if any, resulting from Seller's failure to close the sale of the Property.
156

157 **8. Closing of Sale.** Buyer and Seller agree the sale of the Property shall be
158 closed on or before June 25, 2008 in the Escrow. The sale shall be deemed "closed" when
159 the document(s) conveying title to the Property is recorded and the Purchase Price (increased
160 or decreased, as the case may be, by the net amount of credits and debits to Seller's account
161 at Closing made by the Escrow Holder pursuant to the terms of this Agreement) is disbursed
162 to Seller. At Closing, Buyer and Seller shall deposit with the Title Company all documents
163 and funds required to close the transaction in accordance with the terms of this Agreement.
164 At Closing, Seller shall deliver a certification in a form approved by Buyer that Seller is not a
165 "foreign person" as such term is defined in the Internal Revenue Code and the Treasury
166 Regulations promulgated under the Internal Revenue Code. If Seller is a foreign person and
167 this transaction is not otherwise exempt from FIRPTA regulations, the Title Company shall be
168 instructed by the parties to withhold and pay the amount required by law to the Internal
169 Revenue Service. At Closing, Seller shall convey fee simple title to the Property to Buyer by
170 statutory warranty deed or (the "Deed"). If this Agreement provides for the
171 conveyance by Seller of a vendee's interest in the Property by a contract of sale, Seller shall
172 deposit with the Title Company (or other mutually acceptable escrow) the executed and
173 acknowledged Deed, together with written instructions to deliver such deed to Buyer upon
174 payment in full of the purchase price. At Closing, Seller shall pay for and deliver to Buyer a
175 standard ALTA form owner's policy of title insurance (the "Policy") in the amount of the
176 Purchase Price insuring fee simple title to the Property in Buyer subject only to the Permitted
177 Exceptions and the standard preprinted exceptions contained in the Policy.
178

179 **9. Closing Costs; Prorates.** Seller shall pay the premium for the Policy. Seller
180 and Buyer shall each pay one-half of the escrow fees charged by the Title Company, any
181 excise tax, and any transfer tax. Real property taxes for the tax year in which the transaction
182 is closed, assessments (if a Permitted Exception), personal property taxes, rents and other
183 Lessee charges arising from existing Tenancies paid for the month of Closing, interest on
184 assumed obligations, and utilities shall be prorated as of the Closing Date. Prepaid rents,

185 security deposits, and other unearned refundable deposits regarding the Tenancies shall
186 be assigned and delivered to Buyer at Closing. Seller Buyer N/A shall be
187 responsible for payment of all taxes, interest, and penalties, if any, upon removal of the
188 Property from any special assessment or program.

189
190 10. **Possession.** Buyer shall be entitled to exclusive possession of the
191 Property, subject to the Tenancies existing as of the Closing Date, At Close of Escrow
192 or:

193
194 11. **Condition of Property.** Seller represents that, to the best of Seller's
195 knowledge without specific inquiry, Seller has received no written notices of violation of any
196 laws, codes, rules, or regulations applicable to the Property ("Laws"), and Seller is not aware
197 of any such violations or any concealed material defects in the Property which cost more than
198 \$1000 to repair or correct. Risk of loss or damage to the Property shall be Seller's until
199 Closing and Buyer's at and after Closing. No agent of Buyer or Seller has made any
200 representations regarding the Property. BUYER AND SELLER AGREE THAT THE REAL
201 ESTATE LICENSEES NAMED IN THIS AGREEMENT HAVE MADE NO REPRESENTATIONS TO
202 ANY PARTY REGARDING THE CONDITION OF THE PROPERTY, THE OPERATIONS ON OR
203 INCOME FROM THE PROPERTY, THE TENANCIES, OR WHETHER THE PROPERTY OR THE
204 USE THEREOF COMPLIES WITH LAWS. Except for Seller's representations set forth in this
205 section 11, Buyer shall acquire the Property "as is" with all faults and buyer shall rely on the
206 results of its own inspection and investigation in Buyer's acquisition of the Property. It shall
207 be a condition of Buyer's obligation to close, and of Seller's right to retain the Earnest Money
208 as of Closing, that all of the Seller's representations and warranties stated in this Agreement
209 are materially true and correct on the Closing Date. Seller's representations and warranties
210 stated in this Agreement shall survive Closing for one (1) year.

211
212 12. **Personal Property.** This sale includes the following personal property: None
213 or the personal property located on and used in connection with the Property and owned by
214 Seller which Seller shall itemize in a schedule. Seller shall deliver to Buyer such schedule
215 within _____ days after the Execution Date. Seller shall convey all personal property owned
216 by Seller on or in the Property to Buyer by executing and delivering to Buyer at Closing
217 through Escrow by a Bill of Sale.

218
219 13. **Notices.** Unless otherwise specified, any notice required or permitted in,
220 or related to, this Agreement must be in writing and signed by the party to be bound. Any
221 notice will be deemed delivered (i) when personally delivered or delivered by facsimile
222 transmission (with electronic confirmation of delivery), or (ii) on the day following delivery
223 of the notice by reputable overnight courier, or (iii) three (3) days after mailing in the U.S.
224 mails, postage prepaid, by the applicable party in all events, to the address of the other party
225 shown in this Agreement, unless that day is a Saturday, Sunday, or legal holiday, in which
226 event it will be deemed delivered on the next following business day. If the deadline under
227 this Agreement for delivery of a notice or payment is a Saturday, Sunday, or legal holiday,
228 such last day will be deemed extended to the next following business day.

229
230 14. **Assignment.** Buyer may not assign may assign may assign, only if
231 the assignee is an entity owned and controlled by Buyer (may not assign, if no box is

232 checked) this Agreement or Buyer's rights under this Agreement without Seller's prior written
233 consent. If Seller's consent is required for assignment, such consent may be withheld in
234 Seller's reasonable discretion.

235
236 **15. Attorneys' Fees.** In the event a suit, action, arbitration, or other proceeding of
237 any nature whatsoever, including without limitation any proceeding under the U.S. Bankruptcy
238 Code, is instituted, or the services of an attorney are retained, to interpret or enforce any
239 provision of this Agreement or with respect to any dispute relating to this Agreement, the
240 prevailing party shall be entitled to recover from the losing party its attorneys', paralegals',
241 accountants', and other experts' fees and all other fees, costs, and expenses actually incurred
242 and reasonably necessary in connection therewith (the "Fees"). In the event of suit, action,
243 arbitration, or other proceeding, the amount of Fees shall be determined by the judge or
244 arbitrator, shall include all costs and expenses incurred on any appeal or review, and shall be
245 in addition to all other amounts provided by law.

246
247 **16. Statutory Land Use Disclaimer.** THE PROPERTY DESCRIBED IN THIS
248 INSTRUMENT MAY NOT BE WITHIN A FIRE PROTECTION DISTRICT PROTECTING
249 STRUCTURES. THE PROPERTY IS SUBJECT TO LAND USE LAWS AND REGULATIONS,
250 WHICH, IN FARM AND FOREST ZONES, MAY NOT AUTHORIZE CONSTRUCTION OR SITING
251 OF A RESIDENCE AND WHICH LIMIT LAWSUITS AGAINST FARMING OR FOREST
252 PRACTICES AS DEFINED IN ORS 30.930 IN ALL ZONES. BEFORE SIGNING OR ACCEPTING
253 THIS INSTRUMENT, THE PERSON ACQUIRING FEE TITLE TO THE PROPERTY SHOULD
254 CHECK WITH THE APPROPRIATE CITY OR COUNTY PLANNING DEPARTMENT TO VERIFY
255 APPROVED USES AND THE EXISTENCE OF FIRE PROTECTION FOR STRUCTURES.

256
257 **17. Cautionary Notice About Liens.** UNDER CERTAIN CIRCUMSTANCES, A
258 PERSON WHO PERFORMS CONSTRUCTION-RELATED ACTIVITIES MAY CLAIM A LIEN
259 UPON REAL PROPERTY AFTER A SALE TO THE PURCHASER FOR A TRANSACTION OR
260 ACTIVITY THAT OCCURRED BEFORE THE SALE. A VALID CLAIM MAY BE ASSERTED
261 AGAINST THE PROPERTY THAT YOU ARE PURCHASING EVEN IF THE CIRCUMSTANCES
262 THAT GIVE RISE TO THAT CLAIM HAPPENED BEFORE YOUR PURCHASE OF THE
263 PROPERTY. THIS INCLUDES, BUT IS NOT LIMITED TO, CIRCUMSTANCES WHERE THE
264 OWNER OF THE PROPERTY CONTRACTED WITH A PERSON OR BUSINESS TO PROVIDE
265 LABOR, MATERIAL, EQUIPMENT OR SERVICES TO THE PROPERTY AND HAS NOT PAID
266 THE PERSONS OR BUSINESS IN FULL.

267
268 **18. Miscellaneous.** Time is of the essence of this Agreement. The facsimile
269 transmission of any signed document including this Agreement, in accordance with Paragraph
270 13, shall be the same as delivery of an original. At the request of either party, the party
271 delivering a document by facsimile will confirm facsimile transmission by signing and
272 delivering a duplicate original document. This Agreement may be executed in two or more
273 counterparts, each of which shall constitute an original and all of which together shall
274 constitute one and the same Agreement. This Agreement contains the entire agreement and
275 understanding of the parties with respect to the subject matter of this Agreement and
276 supersedes all prior and contemporaneous agreements between them with respect thereto.
277 Without limiting the provisions of Section 14 of this Agreement, this Agreement shall be
278 binding upon and shall inure to the benefit of the parties and their respective successors and

279 assigns. The person signing this Agreement on behalf of Buyer and the person signing this
280 Agreement on behalf of Seller each represents, covenants and warrants that such person has
281 full right and authority to enter into this Agreement and to bind the party for whom such
282 person signs this Agreement to the terms and provisions of this Agreement. This Agreement
283 shall not be recorded unless the parties otherwise agree.
284

285 **19. Addendums; Exhibits.** The following named addendums and exhibits are
286 attached to this Agreement and incorporated within this Agreement: none or Exhibit "A"
287 Agency Disclosure.
288

289 **20. Time for Acceptance.** Seller has until 5:00 p.m. Pacific Time on April 21,
290 2008 to accept this offer. Acceptance is not effective until a copy of this Agreement which
291 has been signed and dated by Seller is actually received by Buyer. If this offer is not so
292 accepted, it shall expire and the Earnest Money shall be promptly refunded to Buyer and
293 thereafter, neither party shall have any further right or remedy against the other.
294

295 **21. Seller's Acceptance and Brokerage Agreement.** By execution of this
296 Agreement, Seller agrees to sell the Property on the terms and conditions in this Agreement.
297 Seller further agrees to pay a commission to First American Title Company (Escrow) in the
298 total amount computed in accordance with (i) the listing agreement or other commission
299 agreement dated: Seller agrees to pay Principal Broker Jim O'Bryant commission as per
300 fee Agreement between Seller and Broker; or (ii) if there is no written commission agreement,
301 Seller hereby agrees to pay a commission of percent of the purchase price or \$.
302 _____ Seller and Broker agree that the commission is deemed earned as of the earlier of (i)
303 Closing or (ii) the date Buyer waives all conditions precedent to Closing as set forth in this
304 Agreement. Unless otherwise provided in a separate written agreement, Seller shall cause
305 the Escrow Holder to deliver to Broker the real estate commission on the Closing Date or upon
306 Seller's breach of this Agreement, whichever occurs first. If the Earnest Money is forfeited
307 and retained by Seller in accordance with this Agreement, in addition to any other rights the
308 Broker may have, the Broker shall be entitled to the lesser of (A) fifty percent (50%) of the
309 Earnest Money or (B) the commission agreed to above, and Seller hereby assigns such
310 amount to the Broker.
311

312 **22. Execution Date.** The Execution Date is the later of the two dates shown
313 beneath the parties' signatures below.

314 **23. Governing Law.** This Agreement is made and executed under, and in all
315 respects shall be governed and construed by the laws of the State of Oregon.
316

317 CONSULT YOUR ATTORNEY. THIS DOCUMENT HAS BEEN PREPARED FOR SUBMISSION
318 TO YOUR ATTORNEY FOR REVIEW AND APPROVAL PRIOR TO SIGNING. NO
319 REPRESENTATION OR RECOMMENDATION IS MADE BY THE COMMERCIAL ASSOCIATION
320 OF REALTORS® OREGON/SW WASHINGTON OR BY THE REAL ESTATE LICENSEES
321 INVOLVED WITH THIS DOCUMENT AS TO THE LEGAL SUFFICIENCY OR TAX
322 CONSEQUENCES OF THIS DOCUMENT.
323

324 THIS FORM SHOULD NOT BE MODIFIED WITHOUT SHOWING SUCH MODIFICATIONS BY
325 REDLINING, INSERTION MARKS, OR ADDENDA.


326
327
328
329
330
331
332
333
334
335
336
337
338
339
340
341
342
343
344
345
346
347
348
349
350
351

Buyer: 
Elwood Martin

Date: 4-8-08

Buyer: _____

Date: _____

Seller: 
Northwest Natural Gas Co.

Northwest Natural Gas Co.

By: Mark S. Dodson

By: _____

Title: Chief Executive Officer

Title: _____

Date: 5-16-08

Date: _____

EXHIBIT "A" AGENCY DISCLOSURE

COMMERCIAL ASSOCIATION OF REALTORS® OREGON/SW WASHINGTON
PURCHASE AND SALE AGREEMENT AND RECEIPT FOR EARNEST MONEY
(Oregon Commercial Form)

AGENCY ACKNOWLEDGMENT

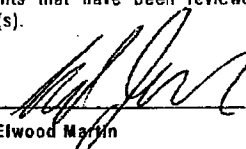
Buyer shall execute this Acknowledgment concurrent with the execution of the Agreement below and prior to delivery of that Agreement to Seller. Seller shall execute this Acknowledgment upon receipt of the Agreement by Seller, even if Seller intends to reject the Agreement or make a counter-offer. In no event shall Seller's execution of this Acknowledgment constitute acceptance of the Agreement or any terms contained therein.

Pursuant to the requirements of Oregon Administrative Rules (OAR 863-015-0215), both Buyer and Seller acknowledge having received the Oregon Real Estate Agency Disclosure Pamphlet, and by execution below acknowledge and consent to the agency relationships in the following real estate purchase and sale transaction as follows:


- (a) (agent name) Jim O'Bryant of HCS Commercial Real Estate firm) (Selling Licensee) is the agent of (check one): Buyer exclusively; Seller exclusively; both Seller and Buyer ("Disclosed Limited Agency")
- (b) (agent name) Steve Watt of Northwest Natural Gas Co. (firm) (Listing Licensee) is the agent of (check one): Buyer exclusively; Seller exclusively; both Seller and Buyer ("Disclosed Limited Agency").

If the name of the same real estate firm appears in both Paragraphs (a) and (b) above, Buyer and Seller acknowledge that a principal broker of that real estate firm shall become the Disclosed Limited Agent for both Buyer and Seller, as more fully set forth in the Disclosed Limited Agency Agreements that have been reviewed and signed by Buyer, Seller and the named real estate licensee(s).

ACKNOWLEDGED

Buyer:  Date: 4-8-08
Elwood Martin

Buyer: _____ Date: _____

Seller:  Date: 5-16-08
Northwest Natural Gas Co.

Seller: _____ Date: _____
Northwest Natural Gas Co.

DISCLOSURE REGARDING AGENCY RELATIONSHIP(S)
(As required by Oregon Revised Statutes Chapter 696)
(ATTACH TO AGENCY DISCLOSURE ACKNOWLEDGMENT FORM)

An agency relationship arises whenever two persons agree that one is to act on behalf of the other and in accordance with the other's directions. The creation of an agency relationship imposes certain legal duties on the agent.

Before a seller or a buyer enters into a discussion with a real estate licensee regarding a real property transaction, the seller and the buyer should each understand what type of agency relationship or representation the buyer and the seller may have with each agent in that transaction.

SELLER'S AGENT

An agent who acts under a listing agreement with the seller acts as the agent for the seller only. A seller's agent has affirmative obligations (under section 3 of this 1993 Act):

- (1) To the seller: The fiduciary duties of loyalty, obedience, disclosure, confidentiality, reasonable care and diligence, and accounting in dealings with the seller.
- (2) To the buyer and to the seller: Honest dealing and disclosure.

BUYER'S AGENT

A real estate licensee other than the seller's agent can agree with the buyer to act as the agent for the buyer only. In this situation, the buyer's agent is not representing the seller, even if the buyer's agent is receiving compensation for services rendered, either in full or in part, from the seller or through the seller's agent. A buyer's agent has the affirmative obligations (under section 4 of this 1993 Act):

- (1) To the buyer: The fiduciary duties of loyalty, obedience, disclosure, confidentiality, reasonable care and diligence, and accounting in dealings with the buyer.
- (2) To the buyer and to the seller: Honest dealing and disclosure.

SELLERS AND BUYERS

None of the foregoing duties of the agent in a real estate transaction relieves a seller or a buyer from the responsibility to protect the seller's or buyer's own interests respectively. The seller and the buyer should carefully read all agreements to assure that the agreements adequately express the seller's or the buyer's understanding of the transaction.

IN-COMPANY SALES

- (1) A licensee, acting either alone or through one or more licensees within the same real estate organization, may give limited representation to both the seller and the buyer in a real estate transaction.
- (2) In an in-company agreement, the agent acting as an in-company agent has the following affirmative obligations to both the seller and the buyer:
 - (a) Loyalty, obedience, disclosure, confidentiality, and accounting in dealings with both the seller and the buyer. HOWEVER, IN REPRESENTING BOTH THE SELLER AND THE BUYER, THE LICENSEE SHALL NOT, WITHOUT THE EXPRESS WRITTEN PERMISSION OF THE RESPECTIVE PERSON, DISCLOSE TO THE OTHER PERSON:
 - (i) That the seller will accept a price lower than or terms less favorable than the listing price or terms; or
 - (ii) That the buyer will pay a price higher than or terms more favorable than the offering price and terms; or
 - (b) Other than price and terms, confidential information specifically designated as such in writing by the buyer or seller as set out on form 26 "Agency Disclosure Acknowledgment" attached.
 - (b) Reasonable care and diligence.
 - (c) Honest dealing.

**THE ACTS OF THE AGENTS MAY CAUSE LEGAL LIABILITY
TO THE PRINCIPALS.**

**A REAL ESTATE LICENSEE IS QUALIFIED TO ADVISE ON REAL ESTATE;
IF YOU DESIRE LEGAL ADVICE, CONSULT A LAWYER.**

**PROMISSORY NOTE
(For Earnest Money)**

\$10,000.00

Date: April 8, 2008

KNOW ALL MEN BY THESE PRESENTS that Elwood Martin (Buyer) does hereby promise to pay to the order of Northwest Natural Gas Co (Seller) the sum of Ten Thousand Dollars and no/100 ----- Dollars (\$10,000.00) with interest thereon at the rate of zero percent (0%) per annum from the date of this note until paid in -full. This note is due and payable within ~~three days (3) after acceptance of Agreement, or before one day after satisfaction or waiver by Buyer of the conditions to Buyer's obligation to purchase the property set forth in the attached agreement between Elwood Martin and Northwest Natural Gas Co.~~

In the event of closing of this transaction, all accrued interest shall be forgiven.

This note is intended to be a deposit of earnest money in the above referenced transaction, and shall be subject to the terms and conditions of that agreement, a copy of which is attached hereto. Said Earnest Money Agreement shall govern and control the effectiveness or cancellation of this note in the event this transaction does not close.

If this note is placed in the hands of an attorney for collection, we promise and agree to pay holder's reasonable attorneys fees, costs, disbursements and other collection costs, even though no suit or action is filed hereon; if a suit or action is filed, the amount of such reasonable attorneys fees shall be fixed by the court or courts in which the suit or action, including any appeal therein, is tried, heard, or decided. HCS Commercial Real Estate, LLC. does not maintain a Client's Trust Account. All money collected shall be immediately deposited at Escrow Company as identified in Purchase and Sale Agreement.

DATED the date first above written, at Salem, Marion County, Oregon.


Buyer: Elwood Martin

4-8-08
Date:

ADDENDUM TO PURCHASE AND SALE AGREEMENT AND RECEIPT FOR EARNEST MONEY

THIS ADDENDUM TO PURCHASE AND SALE AGREEMENT AND RECEIPT FOR EARNEST MONEY ("Addendum") is made by and between NORTHWEST NATURAL GAS COMPANY, as Seller, and ELWOD MARTIN.

RECITALS

A. Buyer signed and submitted to Seller that certain Commercial Association of Realtors Oregon/ SW Washington Purchase and Sale Agreement And Receipt for Earnest Money dated April 8, 2008 (the "Sale Agreement").

B. The Sale Agreement concerns the sale by Seller to Buyer of the property described in the Sale Agreement (the "Property"). Seller desires to sell the Property to Buyer and Buyer desires to purchase the Property from Seller upon the terms and conditions set forth in the Sale Agreement, as modified by this Addendum.

C. The parties enter into this Addendum to modify the terms and conditions of the Sale Agreement and evidence such additional agreements as more fully set forth below.

AMENDMENT OF SALE AGREEMENT

The following Section numbers correspond to the Section numbers of the Sale Agreement and the same are amended and modified as follows:

2. **Earnest Money Deposit.** The amount of earnest money shall be \$25,000 and shall initially be in the form of a promissory note as set forth in Section 2 of the Sale Agreement. Buyer shall, contemporaneously with the execution of this Addendum, execute and deliver to the Title Company the Earnest Money Note.

3A. **Conditions to Purchase – Tax Deferred Exchange.** Section 3A of the Sale Agreement is moved (so that it is no longer a part of Section 3) and fully incorporated in as newly created Section 24 of the Sale Agreement.

4. **Property Inspection.** Buyer shall not perform any invasive testing of the Property without Seller's prior written consent. Prior to entering the Property to conduct any inspection, testing or survey, Buyer shall procure and deliver to Seller evidence reasonably acceptable to Seller that Buyer has in place a commercial general liability insurance policy that names Seller as an additional insured.

5. **Seller's Documents.** The documents that Seller shall deliver to Buyer are listed in Attachment A hereto. Buyer acknowledges that Seller may have other documents relating to the Property. Seller makes no representation or warranty of any kind to Buyer as to the accuracy or completeness of such documents. Buyer acknowledges that Seller is providing these

documents as an accommodation to Buyer and that Buyer shall have no right to rely on the information or conclusions set forth in such documents.

7. **Default, Remedies.** Buyer's remedy for Seller's default shall be limited to specific performance; in no case shall Buyer have an action for damages against Seller.

8. **Closing of Sale.** Seller shall deliver to Buyer at closing a special warranty deed, which shall include an exception for "all matters that would be shown by a true and correct survey."

11. **Condition of Property.** The first sentence of Section 11 is hereby deleted. Buyer acknowledges that Seller has not made and does not make any representations or warranties of any kind concerning the Property. Buyer acknowledges that it is purchasing the Property in its "as is" condition as set forth in Section 11 of the Sale Agreement, as expanded by Additional Provisions, Paragraph 1 below.

13. **Notices.**

(a) Any notice to seller shall be sent to the attention of Sandra K. Hart, Manager, Risk, Environment and Land. Seller's notice address and facsimile number is 220 NW Second Avenue, Portland, Oregon 97209, facsimile number (503) 721-2516. Buyer shall contemporaneously send a copy of any notice to Seller to Margaret Kirkpatrick, Esq., Seller's general counsel, at the address of Seller set forth above. Buyer and Seller shall as a courtesy contemporaneously send a copy of any written notice given under the Sale Agreement by email. Seller's email address for such purpose is s2h@nwnatural.com.

(b) Any notice to Buyer shall be sent to the attention of Elwood Martin. Buyer's notice address and facsimile number is PO, Box 4 Shedd Or. 97377, facsimile number 541 497-6262.

14. **Assignment.** Elwood Martin shall continue to remain liable for the performance of Buyer's obligations under the Sale Agreement notwithstanding any assignment.

16. **Statutory Land Use Disclaimer.** Section 16 of the Sale Agreement is deleted in its entirety and replaced with the following:

"THE PROPERTY DESCRIBED IN THIS INSTRUMENT MAY NOT BE WITHIN A FIRE PROTECTION DISTRICT PROTECTING STRUCTURES. THE PROPERTY IS SUBJECT TO LAND USE LAWS AND REGULATIONS THAT, IN FARM OR FOREST ZONES, MAY NOT AUTHORIZE CONSTRUCTION OR SITING OF A RESIDENCE AND THAT LIMIT LAWSUITS AGAINST FARMING OR FOREST PRACTICES, AS DEFINED IN ORS 30.930, IN ALL ZONES. BEFORE SIGNING OR ACCEPTING THIS INSTRUMENT, THE PERSON TRANSFERRING FEE TITLE SHOULD INQUIRE ABOUT THE PERSON'S RIGHTS, IF ANY, UNDER ORS 195.300, 195.301 AND 195.305 TO 195.336 AND SECTIONS 5 TO 11, CHAPTER 424, OREGON LAWS 2007. BEFORE SIGNING OR ACCEPTING THIS INSTRUMENT, THE PERSON ACQUIRING FEE TITLE TO THE PROPERTY SHOULD

CHECK WITH THE APPROPRIATE CITY OR COUNTY PLANNING DEPARTMENT TO VERIFY THAT THE UNIT OF LAND BEING TRANSFERRED IS A LAWFULLY ESTABLISHED LOT OR PARCEL, AS DEFINED IN ORS 92.010 OR 215.010, TO VERIFY THE APPROVED USES OF THE LOT OR PARCEL, TO VERIFY THE EXISTENCE OF FIRE PROTECTION FOR STRUCTURES AND TO INQUIRE ABOUT THE RIGHTS OF NEIGHBORING PROPERTY OWNERS, IF ANY, UNDER ORS 195.300, 195.301 AND 195.305 TO 195.336 AND SECTIONS 5 TO 11, CHAPTER 424, OREGON LAWS 2007."

19. **Addenda; Exhibits.** This Addendum shall be deemed attached to and incorporated within the Sale Agreement.

20. **Time for Acceptance.**

(a) The date by which Seller may execute the Sale Agreement shall be May 8, 2008. Seller shall evidence its execution of the Sale Agreement by signing and dating page 8 of the Sale Agreement and the signature line of this Addendum and delivering to Buyer the entire Sale Agreement and this Addendum.

(b) Buyer shall evidence its acceptance of the modified Sale Agreement by re-executing and dating page 8 of the Sale Agreement and by signing and dating this Addendum and delivering the entire Sale Agreement and this Addendum to Seller.

(c) The "Execution Date" shall be the later of the date that Seller or Buyer executes this Addendum.

21. **Seller's Acceptance and Brokerage Agreement.** Section 21 of the Sale Agreement is deleted in its entirety and replaced with the following:

"If and conditioned upon closing of the sale, Seller shall pay through escrow a real estate commission equal to 3% of the purchase price (that is \$21,300.00) to Jim O'Bryant of HCS NW Commercial Real Estate Services, LLC.
J.O.

ADDITIONAL PROVISIONS

1. **As Is Purchase.** Buyer understands and agrees that the Property is being sold and conveyed, and Buyer agrees to accept the Property, "as is," "where is" and "with all faults" which may exist, without any representation or warranty by Seller. Buyer expressly acknowledges and agrees that (a) Buyer shall be solely responsible for determining the status and condition of the Property, including, without limitation, existing zoning classifications, building regulations and governmental entitlement and development requirements applicable to the Property; and (b) Buyer is relying solely upon such inspections, examination, and evaluation of the Property by Buyer in purchasing the Property on an "as is," "where is" and "with all faults" basis. Buyer further acknowledges that (i) Buyer is a sophisticated investor, knowledgeable and experienced in the financial and business risks attendant to an investment in real property and capable of evaluating the merits and risks of entering into the Sale Agreement and purchasing the Property, (ii) Buyer is entering into the Sale Agreement with the intention of

making and relying upon its own (or its experts') investigation of the physical, environmental, economic and legal condition of the Property, including, without limitation, the compliance of the Property with laws and governmental regulations, and (iii) Buyer is not relying upon any representations and warranties made by Seller or anyone acting or claiming to act on Seller's behalf concerning the Property. Buyer further acknowledges that it has not received from Seller any accounting, tax, legal, architectural, engineering, property management or other advice with respect to this transaction and is relying upon the advice of its own accounting, tax, legal, architectural, engineering, property management and other advisors. Buyer shall purchase the Property in its "AS IS" condition on the Closing Date and assumes the risk that adverse physical, environmental, economic, or other legal conditions may not have been revealed by its investigations.

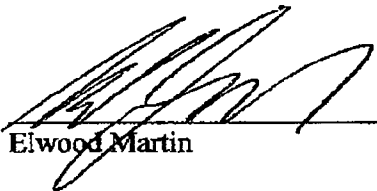
2. **Addendum Control.** Buyer and Seller acknowledge that the terms and conditions of this Addendum shall control over any inconsistencies between this Addendum and the Sale Agreement.

3. **References to Seller and Buyer.** Buyer acknowledges that the correct and full name of Seller is Northwest Natural Gas Company.

IN WITNESS WHEREOF, Buyer and Seller execute this Addendum as of the dates set forth below.

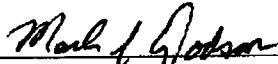
BUYER:

SELLER:



 Elwood Martin

NORTHWEST NATURAL GAS COMPANY

By: 

 Mark S. Dodson, Chief Executive Officer

Execution Date: 5-8-08

Execution Date: 5-16-08

ADDENDUM TO PURCHASE AND SALE AGREEMENT

1. Parties

June 3, 2008

This is an Addendum to a Purchase and Sale Agreement and Receipt for Earnest Money dated: April 8, 2008

Between:

Buyer: Elwood Martin, and/or assigns

Seller: Northwest Natural Gas Company

2. The Property

The Seller owns the property described in the Contract:

(a) The real property is located in or near the city of Albany, County of Linn State of Oregon.

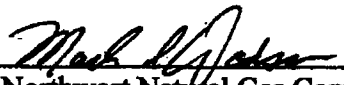
(b) The real property commonly known as (street address) Northwest Natural Gas facility, located at: 730 SW 34th, Avenue, tax acct: R381398, tax lot: #101 and all improvements thereon.

When signed by the Buyer and Seller this addendum will become a part of and will be incorporated by this reference into the Purchase and Sale Agreement and Receipt for Earnest Money referred to above.

- a) **Buyer (Elwood Martin) and Seller (Northwest Natural Gas Company) hereby agree to extend the Buyer's conditions to purchase as stipulated in section 3 of the Purchase and Sale Agreement until July 15, 2008 thus allowing the Buyer, Buyer's lender and environmental consultant time to review and approve of all Seller performed work, documents, testing reports, sampling, analytical conclusions and findings completed, or obtained by the Seller in order to get the NFA letter from DEQ for the previously removed and decommissioned 10,000 gallon underground storage tank. All environmental work performed by Seller to obtain such NFA letter from DEQ shall be completed at the Sellers sole expense.**
- b) **Buyer is aware that the Seller intends to not remove the underground 6,000 gallon poly storage tank that currently resides on the property, Buyer is to complete its own environmental investigations and due diligence related to this specific underground storage tank.**
- c) **Seller hereby agrees to remove all debris piles from the property, and remove all personal property from the subject property before close of escrow.**

d) **Buyer and Seller hereby agree to extend the close of escrow for this transaction until July 30, 2008**

6-12-08
Date:


Seller: Northwest Natural Gas Company

6-4-08
Date:

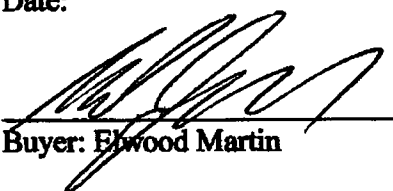

Buyer: Elwood Martin

Exhibit E

A certified excerpt of the minutes of the Company's Board of Director's meeting held December 20, 2007, authorizing the disposition of the Property. Shareholder approval is not required for disposition of the Property.