FitchRatings

FITCH RATES ENERGY NORTHWEST, WA'S ELECTRIC REV RFDG BONDS 'AA'; OUTLOOK STABLE

Fitch Ratings-Austin-10 March 2016: Fitch Ratings has assigned a 'AA' rating to the following revenue refunding bonds issued by Energy Northwest, Washington (ENW) and secured by payments from the Bonneville Power Administration (Bonneville):

--Approximately $183.3 million Project 1 series 2016-A;
--Approximately $85.2 million Columbia Generating Station series 2016-A;
--Approximately $195.8 million Project 3 series 2016-A;
--Approximately $11.3 million Project 1 series 2016-B (taxable);
--Approximately $38.7 million Columbia Generating Station series 2016-B (taxable);
--Approximately $17.6 million Project 3 series 2016-B (taxable).

The bonds are scheduled to price on March 23, 2016, via negotiation. Bond proceeds will refund outstanding debt for all three projects. The transaction will refinance those maturities out longer as part of ENW and Bonneville's regional cooperation debt plan.

Fitch has also affirmed the 'AA' ratings on debt issued by Port of Morrow, the Lewis County Public Utility District, WA, and ENW (prerefunding) and similarly secured by payments from Bonneville:

--$884.7 million ENW Project 1 revenue bonds;
--$3.45 billion ENW Columbia Generating Station revenue bonds;
--$1.11 billion ENW Project 3 revenue bonds at 'AA';
--$377 million Port of Morrow transmission facilities revenue bonds;
--$82 million Lewis County Public Utility District No. 1 Cowlitz Falls hydroelectric project revenue refunding bonds, series 2013.

Fitch affirms the rating on Bonneville Power Administration's implied non-federal revenue obligations at 'AA'.

The Rating Outlook on all ratings is Stable.

SECURITY

Bonneville's payments to ENW for debt service on the bonds are unconditional and are made as an operating expense from the Bonneville Fund.
These 'non-federal' obligations are paid prior to Bonneville's payments on its borrowings from the U.S. Treasury ($4.6 billion) and federal appropriations debt ($3.9 billion).

KEY RATING DRIVERS

BONNEVILLE'S OBLIGATION SECURES BONDS: The rating on the ENW bonds reflects the credit quality of Bonneville and its absolute and unconditional obligation to make payments for debt service. Bonneville has pledged the Bonneville Fund, which includes revenues from its power and transmission business lines.

COMPETITIVE REGIONAL SUPPLIER: Bonneville provides wholesale electricity to a population of more than 12 million in the Pacific Northwest region through a competitive resource portfolio consisting primarily of low-cost hydropower. Transmission services are provided to a similar six-state region but to a broader cast of utilities.

LOW-RISK POWER SALES CONTRACTS: Bonneville sells power through long-term, take-or-pay contracts that recover cost of service from 125 preference customers. The contract terms limit Bonneville's financial exposure to member load increases and lower-than-expected generation output. However, the contracts expire in 2028 and customers are not obligated to continue to purchase from Bonneville if new contracts are not signed.

CASH RESERVE VARIABILITY: Cash reserves have been variable given market price fluctuations and changing hydrology conditions, but strengthened in fiscals 2014 and 2015. Bonneville also has access to a $750 million federal line of credit with the U.S. Treasury Department, which provides additional liquidity.

CAPTIAL NEEDS INCREASING LEVERAGE: Capital needs are sizable in order to fund aging generation infrastructure and new transmission investment in the region. Bonneville's overall leverage is increasing ($2.5 billion over the past five years).

RATING SENSITIVITIES

WEAKENING OF RESERVES: Bonneville Power Administration's reserve levels exhibit variability. While they have strengthened in the past two years, reserve levels remain linked to seasonal hydrological conditions and power market prices received for excess energy sales. The maintenance of strong reserves, given the variation in revenues that can result from these two factors, is key to the ratings and a sustained and sizable reduction in reserves could result in downward rating pressure.

CREDIT PROFILE
ENW, formerly known as the Washington Public Power Supply System, was created in 1957. ENW has 27 members, consisting of 22 public utility districts and the cities of Centralia, Port Angeles, Richland, Seattle, and Tacoma, WA. ENW owns and operates the Columbia Generating Station (CGS), the Packwood Lake Hydroelectric Project, and the Nine Canyon Wind Project. ENW also has financial responsibility for Projects 1 and 3, its terminated nuclear projects.

Bonneville is the largest of the regional federal power marketing agencies within the Department of Energy. Bonneville accounts for around 33% of the electricity consumed and 75% of transmission infrastructure in the region.

BONNEVILLE'S RATING NOT BASED ON DIRECT FEDERAL SUPPORT

The ratings reflect the credit quality of Bonneville as a self-supporting entity. Bonneville's subordinate obligations to the U.S. Treasury offer a layer of structural support to the ENW, Port of Morrow and Lewis County PUD bonds (non-federal debt), in that Bonneville may defer payment to the Treasury, at its discretion. This could provide payment flexibility but Fitch's rating reflects the expected timely repayment on all obligations. A linkage with the federal government exists in the form of governance by the DOE, appointment of the administrator, congressional approval on Bonneville's budget, and the banking and lending relationship with Treasury. However, Fitch's ratings reflect Bonneville's stand-alone credit quality and its ability to repay its obligations from ongoing revenues.

REGIONAL COOPERATION DEBT

Bonneville and ENW have agreed to a regional cooperation debt plan that extends the maturity of outstanding ENW debt (CGS and Projects 1&3) and uses the revenues made available from lower debt service costs on those projects to prepay higher interest rate debt to the U.S. Treasury. While this effectively accelerates payment of Bonneville's subordinate lien obligations by extending the senior ENW bond maturity, it makes available federal borrowing capacity and provides economic benefit to preference customers, who are the ultimate ratepayers that repay both types of debt.

SUFFICIENT POWER SUPPLIES; RELIANCE ON NET SECONDARY REVENUES

Bonneville is statutorily required to provide power to preference customers in the region. Bonneville currently makes power sales to preference customers under 20-year contracts that became effective in fiscal 2012. The contracts limit Bonneville's role as a regional provider to the allocation of the existing federal system (predominantly hydro-electric generation but including CGS) at cost-based rates.

For operational planning purposes, Bonneville uses an assumption of water conditions below the 30-year average, referred to as critical water. Bonneville estimates its available generation resources will produce 8,089 aMW of firm energy under low (or critical) water conditions in fiscal 2017. This represents the amount of firm energy (Tier 1) Bonneville plans to have available to divide among its preference customers, with an estimated demand in fiscal 2017 of 6,934 aMW. Bonneville's other power sales include small amounts to federal agencies in the region and direct service industrial customers. The remaining power produced is sold into the market.

For ratemaking and financial planning purposes, Bonneville considers the additional energy production available for sale under 'average' water conditions. The federal system is expected to produce 10,309 aMW in 2017, based on average water conditions. The production in excess of estimated demand is assumed to be sold at forward market prices, with revenues used to supplement sales to preference customers. These wholesale sales, netted against market purchases made by Bonneville during certain months of the year to shape the output of the federal system, compose net secondary system revenues.

RESERVE VARIABILITY

Bonneville's sizable hydro-electric generation fleet requires market sales in some months and market purchase in other months to balance the load demands with actual output of the federal system. While Bonneville has reduced its financial reliance on net secondary revenues in recent years, there continues to be a degree of variability in net secondary revenues in the power business line. The risk of revenue variability is managed through cash reserves and ultimately, a cost recovery adjustment clause that can be enacted in Tier 1 rates, if needed.

Bonneville's reserves for risk, or unencumbered reserves, improved in fiscals 2014 and 2015, after five previous years of declines. At the end of fiscal 2015, Bonneville had $845 million in unencumbered reserves. The balance of reserves between the power ($395 million) and transmission ($450 million) business lines had become more equitable as well. Management estimates included in the rate case approved for fiscals 2016 and 2017 indicate that reserves will stay in the same general range. -

LARGE CAPITAL INVESTMENTS NEEDED; INCREASING LEVERAGE

As with many utilities across the county, Bonneville faces the issue of aging infrastructure and delayed capital reinvestment. Capital needs over the next five years are estimated at $4.0 billion, with around half of the spending (around $2.2 billion) occurring in the transmission business line. These amounts do not include approximately $600 million that ENW estimates will be needed at CGS through 2024. Capital needs are expected to continue to place upward pressure on Bonneville's rates. Bonneville raised its power rates 7.l% and transmission rates 4.4% on October 1, 2015.

Bonneville and its customers face the challenge of funding upgrades and improvements to the valuable fleet of aging hydroelectric facilities. Although the assets are owned by the Bureau of Reclamation and U.S. Army Corps of Engineers, Bonneville makes the decisions regarding the pace and scope of capital reinvestment. Bonneville does not have authority to issue its own debt and has a statutory debt limit with the U.S. Federal Treasury of $7.7 billion ($4.6 million outstanding at year-end fiscal 2015), making capital funding decisions complex. The Port of Morrow or similar lease financing structures provide financing for transmission assets while the regional cooperation debt strategy frees up ongoing treasury capacity as non-federal debt is extended.

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Applicable Criteria
Revenue-Supported Rating Criteria (pub. 16 Jun 2014)
https://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=750012
U.S. Public Power Rating Criteria (pub. 18 May 2015)
https://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=864007