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

Fitch Ratings-Austin-22 September 2015: Fitch Ratings assigns its 'AA' rating to the following bonds issued by Energy Northwest, Washington and secured by payments from the Bonneville Power Administration (Bonneville):

--Approximately $43 million Project 1, series 2015C;
--Approximately $40 million Columbia Generating Station, series 2015C;
--Approximately $27 million Project 3, series 2015C.

The bonds are scheduled to price on Sept. 29, 2015, via negotiation. Bond proceeds will refund a short-term borrowing that was done to repay debt service due for all three projects on July 1, 2015. The transaction will refinance those maturities out longer as part of Energy Northwest and Bonneville's regional cooperation debt plan.

The Rating Outlook is Stable.

SECURITY

Bonneville's payments to Energy Northwest for debt service on the bonds are unconditional and are made as an operating expense from the Bonneville Fund. The 2015C bonds are parity with ENW's outstanding $5.33 billion in electric revenue bonds, $85 million in Cowlitz Falls hydro bonds and $278 million in Port of Morrow bonds. These bond payments are paid prior to Bonneville's payments on its borrowings from the U.S. Treasury ($4.2 billion) and federal appropriations debt ($4.1 billion).

KEY RATING DRIVERS

BONNEVILLE'S OBLIGATION SECURES BONDS: The rating on the Energy Northwest 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 showed some strengthening in fiscal 2014 and to date in fiscal 2015. Bonneville also has access to a $750 million federal line of credit with the U.S. Treasury Department, which provides additional liquidity.

LIMITED CAPITAL ACCESS: Bonneville's access to capital is limited as it cannot issue debt on its own and has a $7.7 billion ceiling on borrowing from the U.S. Treasury. However, Fitch expects that access to alternative forms of financing will be sufficient to meet Bonneville's significant capital needs.

RATING SENSITIVITIES

FURTHER RESERVE DECLINES: Bonneville Power Administration has taken steps to reduce its reliance on net secondary revenues in recent years. However, a further trend of net secondary revenues lower than expected and declining cash reserves could pressure the ratings.

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 approximately 28% of the electricity consumed and 75% of the transmission infrastructure in the region. The majority of Bonneville's revenues are provided by power operations. Transmission revenues accounted for 26% of operating revenues in fiscal 2014.

BONNEVILLE'S RATING NOT BASED ON DIRECT FEDERAL SUPPORT

The 2015C bond rating reflects 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, in that Bonneville may defer payment to the Treasury, if necessary, which could provide flexibility to the payment obligations ahead of Treasury, but Fitch's rating reflects the expected timely repayment on all obligations. While 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, the rating reflects Bonneville's ability to repay its obligations from ongoing revenues.

REGIONAL COOPERATION DEBT

Bonneville and Energy Northwest have agreed to a regional cooperation debt plan that will extend maturities of ENW debt (CGS and Projects 1&3) and use 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 provides additional federal borrowing capacity and provides economic benefit to preference customers.

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 the total federal system will produce 8,136 aMW of firm energy under low (or critical) water conditions in fiscal 2016. 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 2016 of 6,981 aMW. Bonneville's other power sales include small amounts to federal agencies in the region and direct service industrial customers. The remaining capacity can be 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 10,507 aMW in 2016, 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 will continue to require 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, if needed.

Bonneville's reserves for risk, or unencumbered reserves, improved to $784 million in fiscal 2014, after five previous years of declines. However, only $273 million of the reserves were in the power business line while the remaining reserves represented a strong reserve position in the transmission business line.

Management estimates, based on performance through the third quarter of fiscal 2015, that reserves will end fiscal 2015 above fiscal 2014 levels and the reserves specific to the power business line will improve.

LARGE CAPITAL INVESTMENTS NEEDED

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 $4.2 billion, with most 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 will raise its power rates 7.l% and transmission rates 4.4% on Oct. 1, 2015.

Bonneville and its customers face the challenge of funding upgrades and improvements to the valuable fleet of aging hydroelectric facilities, which is likely to place upward pressure on Bonneville's cost structure. 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, complicating capital funding decisions. The Port of Morrow or similar lease financing structures are expected to provide financing for transmission assets while the regional cooperation debt strategy frees up ongoing treasury capacity.

Bonneville and its customers have elected to fund energy efficiency programs of around $100 million annually from rates beginning in fiscal 2016 rather than capitalizing the expenditures as had been done in the past. This reduces future capital funding needs and reflects a commitment by Bonneville and its customers to raise rates to fund energy efficiency.

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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