Fitch Ratings

FITCH RATES ENERGY NORTHWEST (WA) ELEC REV RFDG BONDS 'AA'; OUTLOOK STABLE

Fitch Ratings-Austin-28 March 2014: Fitch Ratings assigns 'AA' ratings to the following bonds issued by Energy Northwest (ENW), WA and secured by payments from the Bonneville Power Administration (Bonneville):

--Approximately $531.0 million Columbia Generating Station electric revenue refunding bonds, series 2014-A;
--Approximately $90.7 million Columbia Generating Station electric revenue refunding bonds, series 2014-B (taxable);
--Approximately $26.0 million Project 3 electric revenue refunding bonds, series 2014-A.

The bonds are scheduled to price the week of April 7, 2014, via negotiation. Approximately $200 million of the Columbia Generating Station proceeds will fund new improvements to the project. Remaining bond proceeds will refund outstanding bonds for savings, extension of the 2014 maturity for Columbia Generating Station ($50 million), and pay cost of issuance. The Series 2014 bonds will not have a debt service reserve fund.

Fitch also affirms the following outstanding ratings on parity debt issued by Energy Northwest (ENW), Cowlitz Falls and the Port of Morrow, OR, and secured by payments from Bonneville:

--$1.05 billion ENW Project 1 revenue bonds at 'AA';
--$3.18 billion ENW Columbia Generating Station revenue bonds at 'AA';
--$1.23 billion ENW Project 3 revenue bonds at 'AA';
--$84.7 million Port of Morrow transmission facilities revenue bonds), series 2012 (taxable) at 'AA';
--$88.0 million Lewis County Public Utility District No. 1 Cowlitz Falls hydroelectric project revenue refunding bonds, series 2013 at 'AA'.

Fitch also affirms Bonneville's implied non-federal revenue obligations at 'AA'.

The Rating Outlook for all bonds is Stable.

SECURITY

The bonds are on parity with ENW's outstanding $5.5 billion in electric revenue bonds and the outstanding Port of Morrow transmission revenue bonds and Lewis Public Utility District No. 1 Cowlitz Falls hydro bonds.

Bonneville's payments are made as an operating expense from the Bonneville Fund. These payments are paid prior to Bonneville's payments on borrowings from the U.S. Treasury ($3.9 billion) and federal appropriations ($4.3 billion).

KEY RATING DRIVERS

BONNEVILLE'S OBLIGATION SECURES BONDS: The ratings on the ENW, Cowlitz Falls, and Port of Morrow bonds reflect the credit quality of Bonneville's and its absolute and unconditional obligation to make payments for debt service.

COMPETITIVE REGIONAL SUPPLIER: Bonneville has a competitive resource portfolio of 8,506 average annual megawatts (aMW; a measure that reflects firm capacity under low water flow conditions) that provides wholesale electricity (primarily low-cost hydropower) to a population of more than 12 million in the Pacific Northwest region.

LOW-RISK POWER SALES CONTRACTS: Bonneville sells power through long-term, take-or-pay contracts through 2028 that recover cost of service from 125 preference customers. New contracts went into effect in fiscal 2012 that limit Bonneville's financial exposure to member load increases and lower-than-expected output from the federal system.

TWO YEAR RATE SETTING: Bonneville sets rates based on a two-year rate cycle, with mid-period cost adjustments allowed if certain financial thresholds are triggered. Increases in Bonneville's tier 1 power rate (9%) and transmission rate (11%) in fiscal 2014, are expected to stabilize financial performance.

WHOLESALE MARKET RISK REDUCED: Bonneville's financial performance relies on net secondary revenues from wholesale market power sales. Lower than expected net secondary revenues have pressured financial margins and reserves. Positively, Bonneville has lowered its reliance on forecasted secondary revenues in its past two rate cases and replaced those revenues from contracted power sales.

DECLINING POWER RESERVES: Declining reserves remains a concern but is somewhat mitigated by interim rate setting options available to Bonneville and a $750 million federal line of credit with the U.S. Treasury Department.

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 REVENUE AND RESERVE DECLINES: A continuing trend of lower net secondary revenues than expected and declining cash reserves could pressure the ratings.

CREDIT PROFILE

ENERGY NORTHWEST

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&3, nuclear projects that were terminated.

BONNEVILLE POWER ADMINISTRATION

Bonneville is the largest of the regional federal power marketing agencies within the Department of Energy. Bonneville was created by Congress in 1937 to market electric power from the Bonneville Dam in the Pacific Northwest region. Bonneville accounts for approximately 33% of the electricity consumed and 75% of the transmission infrastructure in the region.
Bonneville utilizes the energy from the Columbia Generating Station (CGS), a 1,157 MW nuclear plant, as part of its power supply portfolio (approximately 10% of total power supply). Remaining

power supply is provided by 31 federally-owned hydroelectric plants. Bonneville is obligated to pay debt service on the ENW bonds related to CGS and Projects 1 & 3.

DOE INVESTIGATION INTO HIRING PRACTICES

The Department of Energy (DOE) began an investigation in 2012 into Bonneville's hiring practices during the years 2010 to 2012 that were viewed to be in violation of rules and policies established by the DOE. As a result, the DOE put two top officials at Bonneville on administrative leave in the summer of 2013 and sent a team to Bonneville's headquarters to further investigate the extent of the problem. Bonneville's hiring authority was revoked by the DOE and has not yet been restored. All hiring must be coordinated through the DOE.

Fitch believes that the DOE investigation, turnover at the senior management level, and the workload to review past hiring decisions with DOE oversight have represented a distraction to Bonneville management and staff, however the financial costs related to the investigation should be of a magnitude that will be easily absorbed within annual operations. The appointment of permanent senior management and progress towards restoration of Bonneville's independent hiring authority are viewed as positive developments.

PRESSURE CONTINUES ON NET SECONDARY REVENUES

Bonneville has faced financial pressure for the past five years resulting from low power market prices for its secondary sales. Bonneville's net secondary sales result from the portion of the federal system that is excess to the load demand allocated under preference contracts. Cost-based rates for preference customers are established using extensive modeling of potential hydrological conditions but assume some level of net secondary revenues based on average water conditions and forecast market prices. These revenues have been lower than projected due to below average water conditions and low market prices, requiring the use of cash reserves in fiscals 2009 - 2013 to replace lower revenues.

Net secondary revenues have fallen to around 10% of total revenues in the past three years from more robust levels prior to 2009. Net secondary revenues in fiscal 2010 fell to a low of negative $116 million in fiscal 2010 but increased to $345 million in fiscal 2013. Rate setting in fiscal 2014 assumed reduced net secondary sales of approximately $300 million. Initial indications as of the end of the first quarter in fiscal 2014 were below this conservative forecast at a projected $164 million. Since this estimate, streamflows have increased from 80% to 101% of average levels according the National Weather Service, and Bonneville anticipates that its estimate of secondary revenues at the end of the second quarter of fiscal 2014 will be closer to the level forecast in the rate case.

FINANCIAL FLEXIBILITY REMAINS

Bonneville's reserves have declined in recent years. However, Bonneville's risk profile has also lessened over this time period with the new power contracts, flexibility to adjust rates through cost adjusters and reduced reliance on net secondary revenues in its rate setting. Bonneville's reserves for risk, or unencumbered reserves, declined to $641 million in fiscal 2013 with $182 million in the power business line and the remaining reserves allocated to transmission. This represents 96 days of operations but when the $750 million line of credit with the U.S. Treasury is included, the liquidity metric is more robust at 209 days.

Bonneville's forecast in its July 2013 rate case estimate was that reserves for risk could decline further to $496 million total by the end of fiscal 2015. However, there is a high degree of variability in this estimate and actual reserve performance will depend on hydrological flows in the region, timing of those flows and market prices. Fitch believes that the reduced reliance on net secondary revenues in rate setting should provide greater stability to Bonneville's reserves.

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In addition to the sources of information identified in Fitch's Revenue-Supported Rating Criteria and U.S. Public Power Rating Criteria, this action was informed by information from CreditScope.

Applicable Criteria and Related Research:
--'U.S. Public Power Rating Criteria' (March 18, 2014);
--'2014 Outlook: U.S. Public Power and Electric Cooperative Sector' (Dec. 12, 2013);
--'U.S. Public Power Peer Study Addendum' (Feb. 7, 2014);
--'U.S. Public Power Peer Study' (June 13, 2013).

Applicable Criteria and Related Research:
U.S. Public Power Rating Criteria
http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=740841
2014 Outlook: U.S. Public Power and Electric Cooperative Sector (Calm Under Pressure)
http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=725447
U.S. Public Power Peer Study Addendum
http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=534046