FitchRatings

FITCH RATES ENERGY NORTHWEST (WA) ELECTRIC REV REF BONDS 'AA'; OUTLOOK STABLE

Fitch Ratings-Austin-08 April 2015: Fitch Ratings assigns 'AA' ratings to the following Energy Northwest, WA electric revenue and refunding bonds:

--Approximately $127 million Project 1, series 2015A and 2015B;
--Approximately $638 million Columbia Generation Station, series 2015A and 2015B;
--Approximately $114 million Project 3, series 2015A and 2015B.

The bonds are scheduled to price on April 23, 2015, via negotiation. Bond proceeds of the Columbia Generating Station (CGS) bonds will finance approximately $214 million of project improvements and refund bonds for savings. The remaining funds will refund existing maturities and pay costs of issuance

Fitch also affirms the following outstanding ratings on parity debt issued by Port of Morrow, the Lewis County Public Utility District, WA, and Energy Northwest (ENW), WA and similarly secured by payments from Bonneville:

--$913 million ENW Project 1 revenue bonds at 'AA';
--$3.3 billion ENW Columbia Generating Station revenue bonds at 'AA';
--$1.14 million ENW Project 3 revenue bonds at 'AA';
--$278 million Port of Morrow transmission facilities revenue bonds), series 2012 and 2014 (taxable) at 'AA';
--$85 million Lewis County Public Utility District No. 1 Cowlitz Falls hydroelectric project revenue refunding bonds, series 2013 at 'AA'.

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

The Rating Outlook for all bonds is Stable.

SECURITY

Energy Northwest (ENW) bonds are secured by payments from the Bonneville Power Administration (Bonneville). Bonneville's payment to ENW is made as an operating expense, prior to the U.S. Treasury ($4.2 billion) and federal appropriations ($4.1 billion).

The Port of Morrow bonds and Lewis Public Utility District No. 1 Cowlitz Falls hydro bonds are also secured by payments from Bonneville, with a parity pledge on Bonneville's net revenues that secure the ENW bonds.

KEY RATING DRIVERS

BONNEVILLE'S OBLIGATION SECURES BONDS: The ratings on the ENW, Port of Morrow and Cowlitz Falls bonds reflect 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 the 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. 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 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

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

Fitch's ratings on Bonneville's implied revenue obligations and the related ENW, Port of Morrow, and Lewis County Public Utility District (PUD) No. 1 bonds reflect the credit quality of the administration 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 provides flexibility to the payment obligations ahead of Treasury. 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.

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). The 2015 refunding bonds are the second transaction of this nature and will extend the 2015 bond maturities to 2027 and 2028. 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) at cost-based rates, including CGS.
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 median or '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 done 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 in recent years, there will likely continue to be a degree of variability in revenues, specifically net secondary revenues in the power business line. The risk of revenue variability is managed through cash reserves and ultimately, a rate cost recovery adjustment, 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. Initial rate case indications for end of year fiscal 2015 suggested an possible decline in combined reserves to as low as $496 million but management estimates, based on more recent performance, that reserves will end fiscal 2015 closer to fiscal 2014 levels.

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Applicable Criteria and Related Research:
--'U.S. Public Power Rating Criteria' (March 18, 2014);
--'2015 Outlook: U.S. Public Power and Electric Cooperative Sector' (Dec. 12, 2014);
--'U.S. Public Power Peer Study' (June 12, 2014).

Applicable Criteria and Related Research:
U.S. Public Power Rating Criteria
http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=740841
2015 Outlook: U.S. Public Power and Electric Cooperative Sector (Steady as She Goes)
http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=831228
U.S. Public Power Peer Study -- June 2014
http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=749789