

FITCH RATES PORT OF MORROW (OR) TRANSMISSION FACILITIES REV BONDS 'AA'; OUTLOOK STABLE

Fitch Ratings-Austin-24 November 2014: Fitch Ratings assigns 'AA' ratings to the Port of Morrow, OR Transmission Facilities Revenue Bonds (Bonneville Cooperation Project 2), series 2014.

The bonds are scheduled to price on Dec. 11, 2014, via negotiation. Bond proceeds will finance the acquisition and completion costs of certain transmission facilities that will be owned by the Port of Morrow and leased to the Bonneville Power Administration (Bonneville) according to a lease-purchase agreement.

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 secured by payments from Bonneville:

- \$931 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';
- \$84.7 million Port of Morrow transmission facilities revenue bonds, series 2012 (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's implied non-federal revenue obligations at 'AA'.

The Rating Outlook for all bonds is Stable.

SECURITY

The Port of Morrow bonds are secured by a security interest in the lease payments to the Port of Morrow from Bonneville, which are an absolute and unconditional payment obligation.

Bonneville's payment obligation supporting the bonds is on parity with Bonneville's payment obligation on ENW's outstanding \$5.36 billion in electric revenue bonds, as well as the outstanding Port of Morrow transmission revenue bonds, series 2012 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 (\$4.2 billion) and federal appropriations debt (\$4.1 billion).

KEY RATING DRIVERS

BONNEVILLE'S OBLIGATION SECURES BONDS: The rating on the Port of Morrow bonds reflects the credit quality of Bonneville and its absolute and unconditional obligation to make lease payments to pay debt service.

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.

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 contracts all expire in 2028

and limit Bonneville's financial exposure to member load increases and lower-than-expected output from the federal hydroelectric 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 occurred in Bonneville's tier 1 power rate (9%) and transmission rate (11%) in fiscal 2014 and provided improved financial performance.

RELIANCE ON SURPLUS SALES: 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 in recent years.

DECLINING CASH RESERVES: Cash reserves have trended downward since 2008 with the exception of an increase in fiscal 2014. Concerns regarding Bonneville's decision to operate with lower reserves are somewhat mitigated by its lower risk profile, interim rate-setting options and access to 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 further trend of net secondary revenues lower than expected and declining cash reserves could pressure the ratings.

CREDIT PROFILE

PORT OF MORROW

The Port of Morrow has the authority to own and issue bonds to fund transmission assets throughout the region. This right was validated by a court opinion sought by the Port in March 2012. According to the terms of a lease agreement between the Port of Morrow and Bonneville, Bonneville will make unconditional lease payments directly to the trustee (the Port has assigned the lease revenues to the trustee) that are equal to debt service on the bonds. The lease agreement terminates in 2027 or only once all the bonds are repaid. Bonneville retains all operational control of the transmission assets.

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 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, with all revenues and expenditures required to move through the Bonneville Fund held at Treasury.

RELIANCE ON NET SECONDARY REVENUES

Bonneville has faced financial pressure for the previous five years resulting from low power-market prices for its secondary sales. Fiscal 2014 was the first year that net revenues from secondary sales were in excess of the forecast.

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. Fitch views the use of average water conditions for financial planning as an optimistic assumption given below-average water conditions in eight of the past 10 years.

Rate setting in fiscal 2014 assumed reduced net secondary sales of approximately \$300 million. Bonneville ended the year with \$318 million in net secondary sales due to a gradual lowering of assumed revenues over the past few years and water conditions that were slightly above average, which produced more kilowatt hours to sell into the market.

FINANCIAL FLEXIBILITY REMAINS

The stronger performance in fiscal 2014 led to improved cash reserves for the first time in recent years. Combined reserves for risk for both business lines increased to \$784 million from \$641 million at the end of fiscal 2013. The \$784 million represents 136 days operating cash, excluding expenditures paid to Energy Northwest on the nonfederal debt. When the \$750 million federal line of credit is included the days operating cash increases to 267 days operating cash. However, there is a high degree of variability and future reserves 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. Additionally, Bonneville's risk profile has also lessened over this time period with the new power contracts and the flexibility to adjust rates through cost adjusters.

For more information, see the Fitch report, 'Energy Northwest, WA, and Bonneville Power Administration, OR' dated April 7, 2014, at www.fitchratings.com.

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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' (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

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 -- June 2014

http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=749789

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