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## **Fitch Rates Lewis County PUD No. 1 (WA) Hydro Proj Rev Rfdg Bonds 'AA';**

**Outlook Stable** Ratings Endorsement Policy

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Fitch Ratings-San Francisco-31 May 2013: Fitch Ratings assigns an 'AA' rating to the following bonds issued by Lewis County Public Utility District No. 1, WA and secured by payments from the Bonneville Power Administration (Bonneville):

--\$82.9 million Cowlitz Falls Hydroelectric Project Revenue Refunding Bonds, series 2013.

The Cowlitz Falls hydro project bonds are scheduled to price the week of June 10, 2013, via negotiation. Bond proceeds will refund outstanding Cowlitz Falls hydroelectric project revenue refunding bonds (series 2003 bonds maturing on or after Oct. 1 2014) and pay cost of issuance. The bonds, with a final maturity of April 1, 2032, will extend the original maturity in 2024 but it remains consistent with the term of the power purchase agreement and payment agreement with Bonneville. The Series 2013 bonds will not have a debt service reserve fund.

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

- \$1.3 billion ENW Project 1 revenue bonds at 'AA';
- \$3.2 billion ENW Columbia Generating Station revenue bonds at 'AA';
- \$1.4 billion ENW Project 3 revenue bonds at 'AA';
- \$85 million Port of Morrow transmission facilities revenue bonds (leased financing) at 'AA'.

Fitch also affirms its implied non-federal revenue bond rating for Bonneville at 'AA'.

The Rating Outlook for all bonds is Stable.

### SECURITY

The Cowlitz Falls series 2013 bonds are secured by an unconditional payment obligation from Bonneville. The bonds are on parity with ENW's outstanding \$6.8 billion in electric revenue bonds and the Port of Morrow transmission revenue bonds.

Bonneville's payments to Lewis County PUD, ENW and the Port of Morrow are made as an operating expense and are paid prior to Bonneville's payments on borrowings by the U.S. Treasury (approximately \$7.7 billion in Treasury borrowings and federal obligations outstanding as of Sept. 30, 2012). The implied revenue bond rating for Bonneville reflects its ability to meet its full obligations.

### KEY RATING DRIVERS

**BONNEVILLE'S OBLIGATION SECURES BONDS:** The rating on the Cowlitz Falls, ENW and Port of Morrow bonds is the same as the implied revenue bond rating for Bonneville, which reflects its absolute and unconditional obligation to make payments for debt service.

**PPA SUPPORTS BONNEVILLE OBLIGATION:** For the Cowlitz Falls bonds, Bonneville's obligation to pay project power costs and debt service is pursuant to a long-term (2032) purchased power agreement (PPA) with Lewis County PUD. Should the PPA ever become unenforceable, a secondary payment agreement between Bonneville and the Trustee ensures continued payment of debt service on the Cowlitz bonds.

**COMPETITIVE WHOLESALE SUPPLIER:** Bonneville has a competitive resource portfolio of about 8,500 MW that provides wholesale electricity (primarily low-cost hydropower) to a population of more than 12 million in the Pacific Northwest region.

**ADVANTAGEOUS POWER SALES CONTRACTS:** Bonneville sells power through long-term, take-or-pay contracts through 2028 that recover cost of service from its 125 preference customers. New contracts went into effect on Oct. 1, 2011 that limit Bonneville's financial exposure to member load increases and lower-than-expected output from the federal system.

**TIMELY RATE RECOVERY:** Bonneville sets rates based on a two-year rate cycle, with mid-period cost adjustments allowed if certain financial thresholds are triggered. Bonneville's next rate case is underway for implementation in fiscals 2014 and 2015. The initial proposal is a 9.6% increase in generation rates and a 13% increase in transmission rates.

**WHOLESALE MARKET RISK:** Bonneville's financial performance relies on secondary revenues from market generation sales in excess of power needed by preference members. Lower secondary revenues than budgeted for the last four years has pressured financial margins, despite Bonneville lowering forecasted secondary revenues in its last rate case. Bonneville assumes a further reduction in the current rate case.

**DECLINING RESERVES:** Financial reserves have been used to support operations and federal repayment obligations due to lower secondary revenues. Power system reserves declined to around \$200 million at the end of fiscals 2012 and 2011 and further decline is anticipated in fiscal 2013. This concern is somewhat mitigated by interim rate setting options available to Bonneville, strong reserves in the transmission business line, and a \$750 million federal line of credit with the U.S. Treasury Department.

**LIMITED CAPITAL ACCESS:** Bonneville does not have authority to issue debt on its own and has a \$7.7 billion ceiling on borrowing from the U.S. Treasury. Bonneville's capital needs exceed its borrowing authority with Treasury. Bonneville is using alternative forms of access to capital to finance its capital needs, such as asset lease financings and member power prepayment.

#### RATING SENSITIVITIES

**CONTINUED RESERVE DECLINES:** Low performance of secondary revenues has placed downward pressure on financial margins and reduced reserves. While fiscal 2013 financial performance is expected to be similar, power reserves (for risk) should stabilize in fiscal 2014-15, as Bonneville incorporates notably less secondary revenues in its rate increase proposal. Failure to maintain adequate financial results for the rating category could pressure the ratings.

**DISRUPTION TO TREASURY ACCESS:** The Bonneville Fund is held at the U.S. Treasury and functionally, the U.S. Treasury acts as Bonneville's bank, where all revenues are required to be deposited and from which bills are paid. Any liquidity constraints at Treasury that put Bonneville payments at risk, particularly those related to debt ceiling restrictions would therefore have to be considered in Bonneville's rating.

#### CREDIT PROFILE

##### Energy Northwest

ENW, formerly known as the Washington Public Power Supply System, was created in 1957. ENW has 28 members, consisting of 23 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 Mile Canyon Wind Project. ENW provides electric service to a population of more than 1.5 million in the region.

##### 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 CGS projects as part of its power supply portfolio (approximately 10% of total power supply) and is obligated to pay debt service on the ENW bonds related to CGS, a 1,157-MW operating nuclear plant, and Project 1 and Project 3, non-operating nuclear plants. BPA is also obligated to make payments on ENW's series 2012D-E bonds, which were issued to finance a prepayment by ENW on nuclear fuel. The other projects owned by ENW (wind and hydroelectric) are separately secured and not supported by Bonneville.

##### Lewis County PUD No. 1

The District's electric utility operations consist of two distinct systems, each accounted for and financed separately. The electric system includes all electric properties used to transmit and distribute electricity to the district's retail customer base (+30,000 customers); and the Cowlitz Falls hydroelectric project which is a standalone, hydroelectric generating facility.

Cowlitz Falls is a 70 MW, run-of-the-river hydropower plant, built on the upper Cowlitz River in eastern Lewis County, WA in 1994. The project operates under a 50-year license, granted by the Federal Energy Regulatory Commission, which expires June 1, 2036. Lewis County PUD is responsible for maintaining and operating the Cowlitz Falls hydro project; while BPA is responsible for paying total project costs (including debt service) as 100% project offtaker, pursuant to a long-term PPA with the district, which expires June 1, 2032. The project output is sold at cost to Lewis County PUD to meet most of its power supply needs.

#### TRANSACTION AGREEMENTS SECURE BONNEVILLE OBLIGATION

According to the terms of the PPA and Cowlitz Falls bond resolution, Bonneville will make unconditional power cost payments to Lewis County, including debt service on the Cowlitz Falls project revenue bonds. It is favorable to note, the debt service payments will be made by Bonneville directly to the Trustee (US Bank National Association). Bonneville's payments to the district are paid as an O&M expense --on parity with ENW and lease obligations (i.e., Port of Morrow) - and ahead of Bonneville's payment obligations to the U.S. Treasury.

In the event the PPA were to be invalidated, a secondary agreement between Bonneville and transaction Trustee ensures that debt service payments on the Cowlitz Falls bonds continue to flow directly to the Trustee. The revenues of Lewis County's electric distribution system are not pledged to support the 2013 Cowlitz Falls bonds.

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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' (Dec. 18, 2012);  
--'Revenue-Supported Rating Criteria' (June 12, 2012).

#### **Applicable Criteria and Related Research:**

U.S. Public Power Rating Criteria  
Revenue-Supported Rating Criteria

#### **Additional Disclosure**

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