

New Issue: Moody's assigns Aa1 to Energy Northwest's (WA) Columbia Generating Station and Project 3 revenue bonds. Rating outlook is stable.

Global Credit Research - 27 Mar 2014

Approximately \$6.9 billion of debt securities affected

ENERGY NORTHWEST, WA
Electric Distribution and Generation
OR

Moody's Rating

ISSUE	RATING
Columbia Generating Station Electric Revenue Bonds, Series 2014-A	Aa1
Sale Amount	\$530,965,000
Expected Sale Date	05/14/14
Rating Description	Revenue: Government Enterprise
Columbia Generating Station Electric Revenue and Refunding Bonds, Series 2014-B (Taxable)	Aa1
Sale Amount	\$90,675,000
Expected Sale Date	05/14/14
Rating Description	Revenue: Government Enterprise
Project 3 Electric Revenue Refunding Bonds, Series 2014-A	Aa1
Sale Amount	\$26,010,000
Expected Sale Date	05/14/14
Rating Description	Revenue: Government Enterprise

Moody's Outlook STA

Opinion

NEW YORK, March 27, 2014 --Moody's has assigned a Aa1 rating to Energy Northwest's (ENW) \$531 million of Columbia Generating Station (CGS) Electric Revenue Bonds, Series 2014-A; \$26 million of Project 3 Electric Revenue Refunding Bonds, Series 2014-A; and \$91 million of Columbia Generating Station Electric Revenue and Refunding Bonds, Series 2014-B (Taxable). These bonds are supported by net billing agreement with Bonneville Power Administration (BPA, Aa1/stable) and thus are rated the same as BPA's other supported obligations. Moody's also affirmed BPA's Aa1 issuer rating and BPA supported ratings comprising of Project No. 1, CGS, Project No. 3, Conservation and Renewable Energy System Conservation Project, Cowlitz Falls Hydroelectric Project, Northwest Infrastructure Financing Corp Transmission Facilities Lease, Port of Morrow Transmission Facilities Revenue Bonds, and Conservation System Project Revenue Bonds. The rating outlook is stable.

Summary Rating Rationale

The Aa1 rating on ENW's CGS, Project 1, and Project 3 and the other BPA supported revenue bonds reflect BPA's contractual obligation to pay including debt service under each respective agreement (e.g. net billing agreement), BPA's long history of meetings its contractual obligations, and BPA's Aa1 issuer rating. For ENW's Project 1 & 3, we also view positively their rapid debt amortization over the next three to four years given their status as partially completed nuclear projects.

BPA's Aa1 issuer ratings benefit from fundamental credit strengths comprising of US Government (Aaa stable)

support features, strong underlying hydro and transmission assets, competitive power costs, and power supply contracts with customers through 2028. Explicit US Government support features include a \$7.7 billion borrowing authority with the US Treasury and the legal ability to defer its annual US Treasury repayment if necessary. BPA's importance to the US Northwest region and its role as a US government agency represent drivers of implicit support. The implicit and explicit support features represents the key factor for the one notch difference between BPA's Aa1 rating and the Aa2 grid indicated rating under the US Public Power with Generation Ownership methodology.

BPA's rating also considers long term credit challenges such as hydrology and wholesale market price risk, environmental burdens, high debt load, lengthy ratemaking process, declining liquidity, and low financial metrics. Hydrology and wholesale market prices are the greatest volatility drivers of BPA's financial performance with an almost \$1 billion swing in net revenues between the best and most challenging years since 2000. The current below average hydrology conditions further emphasizes BPA's inherent revenue volatility due to its over 80% hydro generation concentration and the importance of reserves to blunt the impact of such downside events. BPA's declining internal liquidity remains an ongoing challenge.

BPA's stable outlook considers BPA's FY 2014-15 rates, BPA's near-term ability to withstand difficult market price and hydrology conditions, and BPA's plan to maintain sizeable availability under the US Treasury line. The stable outlook on ENW's CGS, Project 1, Project 3 and other BPA supported obligations reflect BPA's stable outlook.

BPA's rating could be negatively pressured if BPA's internal liquidity drops below 30 days cash on hand on a sustained basis, if US Government support diminishes, federal constraints are placed on BPA or if the US Government ratings are lowered below Aa1. Additionally, ratings on BPA supported revenue bonds could be downgraded if BPA is downgraded or if the underlying contracts (e.g. net billing agreements) are violated.

BPA's rating could improve over the long term if BPA is able to fully mitigate hydrology and wholesale price risk and if BPA implements policies to ensure strong internal risk reserves resulting in at least 250 days cash on hand on a sustained basis. Ratings on BPA supported revenue bonds could be upgraded if BPA is upgraded.

Detailed Credit Discussion

BPA was created in 1937 by an act of the US Congress and is one of four regional power marketing agencies within the US Department of Energy. BPA is primarily responsible for federally owned generation and electric transmission assets in the Pacific Northwest spanning all or parts of eight states. The federal hydro projects serve numerous purposes, including irrigation, navigation, recreation, municipal and industrial water supply, fish and wildlife protection, and power generation. The Army Corps of Engineers and the Bureau of Reclamation operate the hydro projects. Many of the statutory authorities of BPA are vested with the Secretary of Energy, who appoints and acts through the BPA administrator.

BPA operations are divided between Power Services and Transmission Services though all cash flows ultimately flow into one account (BPA Fund) at the US Treasury. The Power Services business is responsible for the revenue and costs of BPA's generation resources and represents the largest segment at 77% of BPA's revenues in FY 2013. Transmission Services is responsible for the revenue and costs of BPA's electric transmission system and generates the remainder of BPA's revenues. BPA's power rates are reviewed and approved by the Federal Energy Regulatory Commission (FERC) according to the Northwest Power Act.

As of September 30th, 2013, BPA had total debt of approximately \$15 billion.

USE OF PROCEEDS: Bond proceeds will be used to refund and extend maturing CGS debt, fund a portion of CGS's long term capital expenditure plans, refinancing bank debt at CGS, and pay for transaction costs. Project 3 bonds will be used to refund existing debt and pay for transaction costs.

LEGAL SECURITY: CGS's and Project 3 bonds are secured by a pledge of specific project revenues primarily sourced under the tri-party net billing agreements with BPA and project participants. The Project 3's pledge is subordinate to \$178.5 million of prior lien bonds. The net billing agreements obligate the project participants, consisting of numerous municipal and cooperative electric utilities, to pay ENW their proportionate share of the project's annual costs, including debt service, irrespective of whether the project is operable or terminated. BPA, in turn, is obligated to pay (or credit) the participants identical amounts by reducing the amounts the participants owe for power and service purchased from BPA under their power-sales agreements. BPA has also agreed, in the event of any insufficient payment by a participant, to pay the amount due in cash directly to the project. In 2007, Energy Northwest and BPA adopted a new direct pay agreement whereby Energy Northwest participants directly pay all costs to BPA rather than through Energy Northwest. BPA has made a clear and tested commitment to

support the payment under the net billing through more than 30 years of stressful circumstances including legal challenges in the early 1980s. There is no debt service reserve. For legal security of other rated BPA supported debt, please see Appendix 2 of 'Bonneville Power Administration: On the Hunt for New Capital Sources' credit focus report for description.

INTEREST RATE DERIVATIVES: BPA's bank financed lease debt has approximately \$950 million of notional interest rate swaps with aggregate mark to market value of negative \$19 million as of February 2014. We understand there are no collateral posting requirements under any conditions.

KEY RATING FACTORS

EXPLICIT AND IMPLICIT US GOVERNMENT SUPPORT FEATURES REPRESENT A MAJOR STRENGTH

While BPA's obligations do not benefit from the full faith and credit of the United States Government, BPA benefits from significant explicit and implicit support elements from the US Government. These support factors primarily consist of a \$7.7 billion borrowing line (\$3.8 billion available), ability to defer payments to the US Treasury, BPA's role as a line agency of the US Department of Energy, and its broader importance to the US Northwest.

BPA is authorized to sell to the US Treasury \$7.7 billion principal amount of bonds. At September 30, 2013, BPA had \$3.89 billion of outstanding borrowings with the US Treasury. The borrowed funds are to be primarily used to fund capital programs including \$1.25 billion allocated for conservation and renewable investments. As subset of the \$7.7 billion, BPA has a \$750 million line of credit, which can be used to fund BPA's operating expenses.

BPA also is required by statute to defer its annual Treasury payments if funds are needed to meet its non-federal debt obligations like the ENW's net billed revenue bonds and thus BPA's US Treasury obligations are considered subordinated to BPA's non-federal debt service obligations. The deferral ability provides BPA a major source of financial flexibility under extreme situations though BPA has not deferred such payments since 1983 and any deferral is likely to have negative political implications. In FY 2013, BPA made debt service payments amounting to \$591 million to the US Treasury.

Strong qualitative considerations for implicit support include BPA role as a line agency of the US Department of Energy and importance to the US Northwest region. Beyond power and transmission services in the northwest, BPA is also responsible for certain treaty responsibilities with Canada, significant regional environmental protection programs, and coordination of river operations. Northwest US representation on key US House and Senate committees that deal with energy legislation is a credit strength. That said, the recent announced retirement of Doc Hastings (WA) who is the Chairman of the House National Resource Committee is viewed negatively.

Overall, we see these strengths as providing at least a 2-3 notch lift to BPA's standalone credit quality and represent key considerations for BPA's Aa1 rating. In a major stress scenario, Moody's expects any US Government support to BPA is likely to be provided through the established US Treasury credit line or deferral of payments to the US Treasury.

DOMINANT TRANSMISSION AND POWER PROVIDER IN REGION

BPA's dominant hydroelectric generation and transmission assets in the Pacific Northwest are considered one of BPA's key fundamental strengths. BPA has roughly 75% of the Pacific Northwest's bulk transmission consisting of 15,000 miles of high voltage transmission lines and 300 substations and other facilities located in BPA's service area.

BPA also indirectly markets energy to nearly 12 million people from 31 federally owned hydroelectric facilities most of which are located on the Columbia River. Output of the federal hydro system provides more than a third of electric power consumed in the region. With almost 22 GW of capacity, BPA is one of the largest rated public power issuer by generating capacity albeit smaller than TVA's 38 GW or large investor owned utilities such as Southern Company's 50 GW and Duke's 65 GW.

HIGHLY COMPETITIVE RATES REPRESENT KEY VALUE PROPOSITION TO THE REGION

Another BPA's major strength is its highly competitive rates charged to its customers. Despite the 9% increase in rates for FY 2014 and 2015, BPA's FY 2014 average tier 1 rate of around \$31.5/MWh is significantly below comparable rates across the US, has remained low on an inflation adjusted basis over the last 30 years, and is competitive in the region. BPA's competitive rates represent a key value proposition to BPA's customers and the Pacific Northwest region that enhances BPA's importance. Additionally, BPA's competitive costs boost rate

flexibility all else being equal. Moody's expects the long-term fundamental strength of BPA's hydroelectric and transmission assets to support BPA's competitive rates and BPA remains well positioned against potentially tougher emissions regulations such as CO2.

LONG TERM CONTRACTS FOR POWER SALES SUPPORT CREDIT QUALITY

Long-term power sales contracts maturing in 2028 with 133 municipally owned utilities, cooperatively owned utilities, and federal agencies support the majority of Power Services's cash flow and BPA's long-term credit quality. Sales to these customers totaled approximately \$1.8 billion in FY 2013 and represent BPA's largest revenue segment at nearly 55% of total revenues. Snohomish County PUD 1 Electric Enterprise, WA (Aa3/stable) is BPA's largest preference customer at 11% of sales and the top ten customers represent approximately 50% of sales assuming conservative water flows. Eight of the top ten customers are highly rated in the 'A' to 'Aa' category and seven are located in Washington State.

Under these long term contracts, BPA provides two services; Load Following and Slice/Block. Load Following customers receive power tied to their net requirements and account for roughly 47% of 2013 total sales (MWh) to Preference Customers. Slice/Block customers receive a combination of fixed blocks of power and a portion of the federal hydro system generation. The Slice portion of the contracts transfer hydrology risk to BPA's customer, which is a credit benefit to BPA. The 16 regional Slice/Block contracts account for roughly 53% of 2013 sales.

LONG AND COMPLEX RATEMAKING PROCESS COULD DELAY TIMELY RECOVERY

BPA's ratemaking procedure involves an extensive process that shares similarities with a rate regulated utility and could create complications and delays in timely recovery of BPA's costs. Northwest Power Act contains specific ratemaking procedures for BPA, mandates justification and reasons in support of such rates, and requires a hearing. The BPA Administrator ultimately decides the rate based on the hearing record including all information submitted. Rates established by BPA may become effective only upon confirmation and approval by FERC. Currently, BPA has rate cases every two years. In a stress situation, BPA could file an expedited rate with FERC and the whole process could take several months for an interim rate approval. Furthermore, within a rate period, BPA is able to charge up to an additional \$300 million per year starting at the beginning of the fiscal year under the Cost Recovery Adjustment Clause (CRAC) if Power Service's accumulated net revenue is below negative \$180 million. A separate NFB Adjustment for certain environmental costs can raise the \$300 million CRAC limit. While the CRAC mechanism adds some flexibility to BPA's two year rate periods, the annual basis of the test and low trigger point limit the benefit of the CRAC mechanism.

Moody's notes that BPA is required by law to propose rates to meet all its costs and that BPA proposes rates at levels whereby it can meet its US Treasury payments at a 95% confidence level based on its cash flows and reserves. BPA's approach should ensure a high probability of near-term payments to the US Treasury and an extremely high probability of near-term timely payments on non-federal debt service.

Notwithstanding the lengthy ratemaking process that BPA operates under, we note that BPA has historically demonstrated a willingness to raise rates in difficult situations such as the power crisis of 2000-2001 when BPA raised rates by 46%. That said, BPA rate setting has historically resulted in low consolidated financial metrics and declining internal reserves since 2008 that reduces resiliency to unexpected events.

BPA HAS A SIGNIFICANT EXPOSURE TO HYDROLOGY AND WHOLESALE POWER PRICE RISKS

BPA's financial results can be materially impacted by hydrology in the Columbia River Basin and wholesale power prices since wholesale power sales represent roughly 10-20% of total revenues in a typical year. Since 2001, hydrology has been extremely volatile with high and low around 130% and 60%, respectively, of the long term average. For FY 2014, regional hydrology was significantly below average during the region's winter peak power needs. Recent rain and snow has resulted in forecasts for average water conditions for the full fiscal year.

Similarly, power prices have also been volatile with a recent peak nearing \$60/MWh in 2008 and a low below \$20/MWh in 2012. These factors, which are outside of BPA's control, have contributed heavily to nearly a \$1 billion swing in net revenues between the best (2006) and most challenging years (2001). We do not expect major improvement in wholesale revenue for the foreseeable future given low demand growth and forward market prices between \$30/MWh to \$35/MWh, which are far below the 2006-2008 average of around \$53/MWh. Actual realized prices by BPA could be lower given the large amounts of new wind in the region and the correlation between peak wind energy production and BPA's peak surplus energy sales.

LOW CONSOLIDATED FINANCIAL METRICS AND DECLINING RESERVES

Moody's views liquidity as a key mitigant to BPA's exposure to hydrology and wholesale price volatility. For FY 2013, BPA had reserves for risk totaling \$641 million (117 days cash on hand) compared to \$1.3 billion (276 days cash on hand) in 2008. The downward trend is expected to continue. For FY 2014, we expect BPA's internal reserves for risk to decline further to between \$480 million and \$600 million depending on hydrology conditions for the remainder of the fiscal year. Given the decline in BPA's internal reserves, BPA is increasing its reliance on the \$750 million operating expense availability under the \$7.7 billion US Treasury line as a source of liquidity for operations. The line of credit expires in October 30, 2015 and any draw needs to be repaid by October 30, 2016. Our rating incorporates the assumption that the line will continue to be extended prior to maturity. We understand BPA is considering a reserve policy and we would view a robust policy that emphasized internal reserves to be credit positive.

On a fully consolidated basis including federal debt, BPA's debt ratio and debt service coverage ratio (DSCR) are low for the rating. Total DSCR has averaged around between 1.0 to 1.1x over the last three years, which was supported by near average to above average hydrology. Looking forward for FY 2014 and 2015, we expect BPA's total DSCR to be around 1.0x depending on hydrology. Excluding federal debt, BPA FY 2013 financial metrics are stronger with non-federal DSCR of 1.73x and non-federal debt ratio of 44% (vs total debt ratio of 96%). These stronger metrics highlight the substantial benefits of federal debt's effective subordination to non-federal debt and these benefits are supportive of the Aa1 rating on non-federal debt.

HIGH CAPITAL EXPENDITURES DRIVES HUNT FOR CAPITAL

BPA's large spending capital program averaging over \$1 billion per year through at least 2017 is a concern since BPA forecasts that its capital needs will result in its \$7.7 billion US Treasury line becoming fully utilized by 2017 without using alternate sources of capital. BPA does not have the ability to directly issue debt publically. The capital expenditures program includes modernizing aging infrastructure, integrating new renewable generation, energy efficiency, and environmental costs. To extend the availability of the US Treasury line, BPA has developed a comprehensive plan, released in 2013 for a rolling 10-year period.

The plan relies on several alternative financing tools such as lease financing, a power prepaid program, conservation third-party financing, reserve and revenue financing, and prioritizing proposed capital investments. BPA has utilized lease financing since 2004 and completed a power prepay in 2013. Moody's incorporates the assumption that, through the use of these alternative financing tools, BPA will maintain significant availability under the US Treasury line. BPA forecasts maintaining at least \$2 billion in most scenarios through at least 2017. Moody's views availability of the US Treasury line one of the credit foundations for BPA since it represents a source of explicit US government support and an important source of external liquidity.

COST BURDEN OF NUCLEAR PROJECTS

Of the original five planned nuclear units, CGS is the only one in operation with all the power economically dispatched by BPA. Consequently, BPA only benefits from power generated at CGS but remains responsible for debt at Project No 1, CGS and Project No 3 that increases BPA's debt burden while reducing BPA's competitiveness. Project 4 and 5 defaulted since they did not have net billing agreements. The debt at all three projects totaled \$5.5 billion at FY 2013 and represented 80% of BPA's non-federal debt and 36% of BPA's total debt. That said, Project 1 & 3 debts totaling \$2.3 billion are expected to be repaid by 2017 and 2018, respectively, which should provide BPA greater financial flexibility that we expect will be offset by rising CGS capital expenditures and debt financed through alternate capital funding sources (e.g. leases). While the Energy Northwest's nuclear related debt is a substantial burden on BPA, Moody's recognizes that the 1,150 MW CGS nuclear plant operates and provides almost 10% of BPA's energy resources.

ENVIRONMENTAL COSTS PUT ADDITIONAL PRESSURE ON CREDIT QUALITY

BPA faces conflicting uses of the Columbia River and environmental regulations, such as the Endangered Species Act (ESA), that contribute significantly to BPA's costs and weighs heavily on BPA's cash flows and competitiveness. Biological opinions prepared by National Oceanic and Atmospheric Administration Fisheries Service and the US Fish and Wildlife Service mandates actions to protect fish species resulting in direct costs such as hatcheries and indirect loss of revenue from hydro dam operational changes. For FY2013, BPA estimates total fish and wildlife costs at approximately \$682 million consisting of \$461 million in direct costs and \$221 million of indirect costs. BPA was able to recover the non-power related environmental costs totaling \$84 million from the US Treasury in FY 2013.

KEY STATISTICS

Aggregate BPA Power Capacity, 2013 Operating Year at median water conditions: 10,585 average megawatts

Non-Federal Debt Service Coverage Ratio, 2013 (reported): 2.2 times

Non-Federal Debt Service Coverage Ratio, 2013 (Moody's): 1.73 times

Total Debt Service Coverage Ratio, 2013 (Moody's): 1.06 times

Available BPA Reserves, 2013 (encumbered and unencumbered): \$ 1.27 billion

Total Reserves Available for Risk, 2013: \$641 million

BPA Payment to U.S. Treasury, 2013: \$692 million

Authorized Line of Credit With U.S. Treasury, 2013: \$7.7 billion (\$3.8 billion available)

BPA Average Tier 1 Rate, 2014: \$31.50/MWh

Columbia Generating Station Nameplate Capacity: 1,130 MW

Non-federal debt, FY 2013: \$6.8 billion

Federal debt, FY 2013: \$8.2 billion

BPA: Public Power Rating Methodology Factors

1. Cost Recovery Framework (25% weight): (Aa)

2. Willingness to Recover Costs and Maintain Sound Financial Metrics (25% weight): (A)

3. Management of Generation Risk (10% weight): (Aa)

4. Rate Competitiveness (10% weight): (Aa)

5. Financial Strength:

Sub factor a) Adjusted Days Liquidity on Hand (10% weight): (131) (A)

Sub factor b) Debt Ratio (10% weight): (46% [non-federal only]-Aa) / (98% [total debt]-Baa)

Sub factor c) Adjusted Debt Service Coverage (10% weight): (1.98x [non-federal only]-A) / (1.08x [total debt]-Ba)

Grid Indicated Rating: Aa3 [non-federal only] / A2 [total debt]

Notching:

Lack of debt service reserve: -0.5

Other (regional importance, borrowing line, deferral ability[total debt only]): +2 [non-federal only] / +3 [total debt]

Scorecard Indicated Rating: Aa2 [non-federal only] / Aa2 [total debt]

ENW CGS: JAA TAKE OR PAY METHODOLOGY FACTORS:

1 Participant Credit Quality and Cost Recovery Mechanism (45%): Aa1

2. Asset Quality (15% weight) Baa (baseline factor)

3. Competitiveness (15% weight): Baa (baseline factor)

4. Financial Strength:

Sub factor a) Adjusted Days Liquidity on Hand: (10%weight): Baa (baseline factor)

Sub factor b) Debt Ratio: (10% weight): Baa (baseline factor)

Sub factor c) Debt Service Coverage Ratio: (10% weight): Baa (baseline factor)

Grid Indicated Rating: Aa1

Notching: None

Scorecard Indicated Rating: Aa1

ENW PROJECT 1 & 3: JAA TAKE OR PAY METHODOLOGY FACTORS:

1 Participant Credit Quality and Cost Recovery Mechanism (45%): Aa1

2. Asset Quality (15% weight) B (baseline factor)

3. Competitiveness (15% weight): B (baseline factor)

4. Financial Strength:

Sub factor a) Adjusted Days Liquidity on Hand: (10%weight): Baa (baseline factor)

Sub factor b) Debt Ratio: (10% weight): B (baseline factor)

Sub factor c) Debt Service Coverage Ratio: (10% weight): Baa (baseline factor)

Grid Indicated Rating: A3

Notching:

Scorecard Indicated Rating: A3

The principal methodologies used in this rating were U.S. Public Power Electric Utilities with Generation Ownership Exposure published in November 2011. The additional methodology for the Northwest Project 1, Project 3, and Columbia Generating ratings was the US Municipal Joint Action Agencies published in October 2012. Please see the Credit Policy page on www.moodys.com for a copy of these methodologies.

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