S&P Global Ratings

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Energy Northwest, Washington Bonneville Power Administration, Oregon; Wholesale Electric

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Energy Northwest, Washington
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Credit Profile		
US$400.88 mil proj 3 elec rev rfdg bnds (Bonneville Pwr Admin) ser 2018-C due 07/01/2028		
Long Term Rating	AA-/Stable	New
US$230.71 mil columbia generating station elec rev rfdg bnds (Bonneville Pwr Admin) ser 2018C due 07/01/2034		
Long Term Rating	AA-/Stable	New
US$3.03 mil columbia generating station elec rev rfdg bnds (taxable) (Bonneville Pwr Admin) ser 2018-D due 07/01/2030		
Long Term Rating	AA-/Stable	New
US$2.79 mil proj 3 elec rev rfdg bnds (taxable) (Bonneville Pwr Admin) ser 2018-D due 07/01/2023		
Long Term Rating	AA-/Stable	New

Rationale

S&P Global Ratings has assigned its 'AA-' rating to the following four series of proposed Energy Northwest (ENW), Wash., bonds:

- $230.71 million Columbia Generating Station (CGS) electric revenue refunding bonds, series 2018-C
- $400.88 million Project 3 electric revenue refunding bonds, series 2018-C
- $3.03 million Columbia Generating Station electric revenue refunding bonds, series 2018-D (taxable)
- $2.79 million Project 3 electric revenue refunding bonds, series 2018-D (taxable)

The outlook is stable.

Bonneville Power Administration (BPA), Ore., will pay the bonds' debt service as operating expenses of its electric system.

At the same time, S&P Global Ratings affirmed its 'AA-' ratings with stable outlooks on existing parity and prior-lien ENW debt and additional nonfederal obligations that BPA pays as an operating expense of its electric system. S&P Global Ratings' 'aa-' stand-alone credit profile on BPA is unchanged.

ENW and BPA will use bond proceeds to refund portions of ENW's existing debt. CGS is ENW's only completed and operating nuclear unit. The incomplete nuclear units 1 and 3 have $1.8 billion of debt and the operating CGS nuclear unit has $3.5 billion. Bonneville has been using ENW refunding transactions to capture debt service savings and defer portions of its ENW debt, freeing funds to retire portions of higher-interest federal appropriation debt more quickly and preserve Treasury borrowing capacity, which is subject to a cap.

At fiscal year-end 2017 (Sept. 30), Bonneville had $15.3 billion of debt obligations, consisting of $2.0 billion of federal appropriations, $5.0 billion of bonds issued to the U.S. Treasury, and $8.3 billion of nonfederal debt that the utility supports. BPA's nonfederal debt includes $2.2 billion of lease obligations and $267 million of customer power prepayments. It pays nonfederal debt from net revenues before it services federal Treasury debt and appropriations.

By re-amortizing $1.4 billion of ENW debt through refunding 2014-2017 refunding transactions, BPA used the savings to accelerate portions of its high interest rate federal appropriations debt. Bonneville labels its use of ENW debt extensions to reduce appropriations and Treasury debt, "Regional Cooperation Debt Refinancings." As federal debt is retired, BPA applies funds that it would have used to pay this principal and interest to accelerate additional portions of its Treasury debt, which is critical to funding Bonneville's capital program. The utility operates under a congressionally imposed $7.7 billion ceiling on its Treasury borrowings. As of fiscal year-end 2017, $5.0 billion of Treasury bonds were outstanding and the utility reports $4.8 billion of 2018-2022 capital spending needs, which underscores the debt management program's essentiality.

BPA expects that managing Treasury debt balances with the savings from ENW debt deferrals will alleviate its borrowing constraints and add years to its Treasury borrowing capacity. The Regional Cooperation refinancings will strengthen nonfederal debt service coverage (DSC) in the near term, but will likely erode DSC in later years because BPA and ENW are deferring nonfederal debt service. During fiscal years 2016 and 2017, Energy Northwest funded portions of its CGS operating and maintenance expenses and part of its debt's interest expenses with a bank loan to defer BPA's costs and facilitate Treasury debt reduction. At maturity, BPA paid $259 million to retire the first of these loans in February 2017. The second loan for $458 million matures in June 2018. In March , BPA reduced the balance outstanding to $365 million. BPA is in the process of borrowing up to $141 million under a third transaction that it entered in December 2017 and matures in December 2018.

The 'AA-' ratings on the nonfederal debt that BPA supports, including the ENW debt, reflect Bonneville's contractual obligations to support the debt and the application of our government-related entities (GRE) criteria. We assess BPA's stand-alone credit profile to be 'aa-' and believe there is a moderately high likelihood that the U.S. government would provide extraordinary support to it in financial distress. We base the latter on our opinion of the strong link between Bonneville and the federal government, as well as the important federal role the agency plays in the Pacific Northwest. However, after downgrading the U.S. to 'AA+' from 'AAA' in August 2011, we no longer view the U.S. government's sovereign credit profile as lifting the ratings on the nonfederal obligations that BPA supports above the utility's stand-alone credit profile.

The GRE rating reflects our view of:

- Bonneville's status as a federal agency;
- The ongoing financial support the federal government provides to the agency through long-term loans and credit lines;
- Congress' increasing the agency's federal borrowing authority in 2009 to $7.70 billion, up $3.25 billion (or 73%). However, Bonneville faces nearly $5.0 billion of 2018-2022 capital spending needs that could consume the headroom between its existing $5.0 billion of U.S. Treasury borrowings and the $7.7 billion cap and Congress has not adjusted the borrowing authority in nearly a decade;
- Legislation that allows BPA to defer repayments of federal obligations if it is in financial distress, which we view as

benefitting nonfederal lenders; and

- The utility's important contributions to the Pacific Northwest's economy, where it indirectly serves a population of about 14 million in eight states, provides power that is critical to the region's economic health, and operates key transmission resources.

Bonneville's stand-alone credit profile reflects our assessment of these additional factors:

- An exceptionally broad and diverse service territory supports the revenue stream.
- The utility achieved nonfederal accrual DSC of 2.9x in 2017, down from 4.5x in 2016 and 4.8x in 2015. These robust levels represent the deferral through re-amortization of portions of the ENW debt service. Accrual coverage of federal and nonfederal obligations trended toward 1.0x in those years, but was 0.7x in 2016 because of the influence of significant accelerated payments of federal appropriations debt.
- The essentially break-even coverage of combined federal and nonfederal debt service reflects rate-setting that relies on a probabilistic analysis of the utility's capacity to meet all of its financial obligations. Other influences include biennial rate cases without intra-period adjustments, Bonneville's operational exposure to variable hydrology conditions, volatile competitive surplus power sales and revenues, and the influence of others' renewable energy resources' that influence power markets' demands and prices for BPA energy.
- Bonneville's 2018-2023 strategic plan sets goals that perpetuate the utility's budgetary assumption of a 95% probability of meeting all federal and nonfederal obligations. The strategic plan's goals also include preserving $1.5 billion of Treasury borrowing capacity and reducing the utility's leverage ratio.
- Highly politicized and protracted biennial rate proceedings can delay rate relief and constrain the benefits of autonomous ratemaking authority and financial flexibility. Nevertheless, Bonneville established electric rates for municipal and electric cooperative customers for fiscal years 2018-2019 at $35.57 per megawatt-hour (MWh), representing a 5.4% increase. It lowered transmission rates by 0.7% to $41.41 per MWh.
- Tiered rates underlying the customer contracts help shield BPA from market volatility by assigning to customers the costs of their energy needs that exceed their allotments of capacity from the federal hydroelectric projects and CGS.
- The unrestricted cash and investments Bonneville records on its balance sheet declined to $628 million in 2017 from $853 million in 2016 and an average of $1.3 billion in 2013-2015. Although 2017's year-end balance remains sound, we believe it does not provide a robust cushion comparable with historical levels that we viewed as tempering the impacts of variable hydrology conditions on financial performance and mitigating credit risks inherent in biennial rate cases. In addition, the utility's 2018-2023 strategic plan projects allowing unrestricted cash and investments to decline to levels equivalent to 60 days' operating expenses, from the current 90 days.
- Although we historically viewed BPA's rates as competitive and fostering strong demand for its generation, the utility reports that recent years' low natural gas prices and the financial stresses of addressing aging infrastructure are eroding its generation's competitiveness. On top of this, the proliferation of economical renewable resources and flat demand for electricity are reducing opportunities to earn surplus sales revenues. Intermittent low-cost renewable resources lack the supply certainty that Bonneville's around-the-clock resources provide.
- Management reports that it needs to enhance competitiveness and demand for the utility's output to preserve its customer base before its 2008-2028 preference customer contracts expire.
- BPA's capital spending program is important to maintaining the integrity of its generation fleet and managing forced outage incidents. Bonneville and ENW project substantial capital needs that could add to both organizations' debt

and consume BPA's Treasury borrowing authority. The utility uses nonfederal financing arrangements, including leases and energy prepayments by its customers, to help preserve federal borrowing capacity.

Outlook

The stable outlook reflects our view that Bonneville's stand-alone credit profile can withstand a further downgrade to the U.S., the potential for October 2017's rate increases to shore up finances, and the remaining term of the 2018-2028 power sales contracts with its customers.

Upside scenario

We do not expect to raise the ratings in the next two years because of the utility's diminished rate competitiveness, the negative effects that low natural gas prices and renewable resources are having on BPA's surplus sales revenues, and the specter of difficulties the utility might face when customers' power supply contracts expire in 2028. Coupled with these exposures are the interplay among BPA's and ENW's sizable capital programs, and our view that improvements in nonfederal debt service coverage ratios reflect the deferral of debt amortization to later years to address the Treasury's cap on Bonneville's borrowings.

Downside scenario

If, during our two-year outlook horizon, BPA does not shore up its competitiveness, liquidity, and revenue stream, including surplus sales revenues, we could lower the stand-alone credit profile. Also, if the utility adds significant nonfederal leverage obligations because of its statutory debt ceiling, there could be negative implications for the stand-alone credit profile and the 'AA-' rating.

Bonneville's Nonfederal Debt Obligations

BPA's nonfederal rated obligations include:

- $5.3 billion of ENW revenue and refunding bonds: $3.5 billion relates to the operating CGS and the balance is for the incomplete units 1 and 3;
- $75.6 million of Public Utility District No. 1 of Lewis County, Wash., Cowlitz Falls project bonds;
- $118.8 million of Northwest Infrastructure Financing Corp. (Schultz-Wautoma project) bonds; and
- $12.8 million of Northern Wasco Public Utility District, Ore. (McNary Dam project) bonds.

Operations

Bonneville markets electricity generated at 31 federal hydroelectric projects, ENW's nonfederal nuclear CGS, and several nonfederal small power plants. It primarily markets these resources' output to the customers of 125 public power and electric cooperative utilities (representing about 88% of energy sales), federal agencies, direct service industries, and the residential and farm customers of six investor-owned utilities. Energy sales represent about 70% of operating revenues. BPA also operates an extensive transmission system that represents about one-quarter of operating revenues. The transmission system facilitates power-marketing activities and represents about 75% of the Pacific Northwest's transmission capacity.

ENW debt-financed two partially completed nuclear reactors and one completed reactor, CGS, a 1,174-megawatt reactor. The nuclear assets' debt is the leading component of nonfederal obligations.

Capital Spending Forecast

Bonneville projects nearly $4.8 billion of 2018-2022 capital projects. In descending order, transmission projects, hydroelectric asset upkeep, fish and wildlife protection, facilities, IT, and security represent the capital program's largest segments. We view investments in the hydroelectric assets as critical to cash flow, particularly because the generating assets have exhibited an above-average forced outage factor relative to the balance of the power industry.

ENW projects about $466 million of 2018-2022 capital projects.

Ratings Detail (As Of May 1, 2018)		
Energy Northwest, Washington		
Bonneville Pwr Admin, Oregon		
Energy Northwest proj 1 Columbia generating station & proj 3 elec rev rfdg bnds (Bonneville Pwr Admin)		
Long Term Rating	AA-/Stable	Affirmed
Energy Northwest proj 1, Columbia Generating Sta, & proj 3 elec rfdg		
Long Term Rating	AA-/Stable	Affirmed
Energy Northwest WHLELC		
Long Term Rating	AA-/Stable	Affirmed
Energy Northwest WHLELC		
Unenhanced Rating	AA-(SPUR)/Stable	Affirmed
Energy Northwest WHLELC		
Long Term Rating	AA-/Stable	Affirmed
Energy Northwest WHLELC		
Long Term Rating	AA-/Stable	Affirmed
Energy Northwest WHLELC		
Long Term Rating	AA-/Stable	Affirmed
Energy Northwest WHLELC		
Long Term Rating	AA-/Stable	Affirmed
Energy Northwest WHLELC		
Long Term Rating	AA-/Stable	Affirmed
Energy Northwest (Bonneville Pwr Admin) Columbia generating station elec rev bnds		
Long Term Rating	AA-/Stable	Affirmed
Energy Northwest (Bonneville Pwr Admin) Columbia Generating Station elec rev & rfdg bnds (Bonneville Pwr Admin)		
Long Term Rating	AA-/Stable	Affirmed
Energy Northwest (Bonneville Pwr Admin) Sub Lien		
Long Term Rating	AA-/Stable	Affirmed
Energy Northwest (Bonneville Pwr Admin) (Nuclear Proj 1,2,3)		
Long Term Rating	AA-/Stable	Affirmed

Ratings Detail (As Of May 1, 2018) (cont.)		
Bonneville Pwr Admin elec rev rfdg (Colu)		
Unenhanced Rating	AA-(SPUR)/Stable	Affirmed
Energy Northwest (Bonneville Pwr Admin)		
Unenhanced Rating	AA-(SPUR)/Stable	Affirmed
Northern Wasco Cnty Peoples Util Dist, Oregon		
Bonneville Pwr Admin, Oregon		
Northern Wasco Cnty Peoples Util Dist (Bonneville Pwr Admin) rev rfdg bnds (Mcnary Dam Fishway Hydroelec Proj)		
Long Term Rating	AA-/Stable	Affirmed
Northern Wasco Cnty Peoples Util Dist (Bonneville Pwr Admin) (McNary Dam Fishway Hydroelec Proj)		
Long Term Rating	AA-/Stable	Affirmed
Northwest Infrastructure Financing Corp., New York		
Bonneville Pwr Admin, Oregon		
Northwest Infrastructure Financing Corp. (Bonneville Pwr Admin) TRANs		
Long Term Rating	AA-/Stable	Affirmed

Many issues are enhanced by bond insurance.