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

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Table Of Contents

Rationale

Outlook

Bonneville's Nonfederal Debt Obligations

Capital Spending Forecast

Operations

Related Criteria And Research

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

Credit Profile

US\$530.965 mil Columbia Generating Station elec rev & rfdg bnds (Bonneville Pwr Admin) ser 2014A due 07/01/2040

Long Term Rating AA-/Stable New

US\$90.675 mil Columbia Generating Station elec rev & rfdg bnds (taxable) (Bonneville Pwr Admin) ser 2014B due 07/01/2040

Long Term Rating AA-/Stable New

US\$26.01 mil proj 3 elec rev rfdg bnds (Bonneville Pwr Admin) ser 2014A due 07/01/2015

Long Term Rating AA-/Stable New

Rationale

Standard & Poor's Ratings Services has assigned its 'AA-' rating to three series of proposed Energy Northwest (ENW), Wash., bonds. Bonneville Power Administration (BPA), Ore., will pay the bonds' debt service as operating expenses of its electric system. The three series of bonds include:

- \$531.0 million Columbia Generating Station (CGS) electric revenue and refunding bonds, series 2014A;
- \$26.0 million Project 3 electric revenue refunding bonds, series 2014A; and
- \$90.7 million CGS electric revenue and refunding bonds, series 2014B (taxable).

At the same time, Standard & Poor's affirmed its ratings on parity ENW debt outstanding and the several nonfederal obligations that BPA pays as an operating expense of its electric system. Standard & Poor's also affirmed its 'aa-' stand-alone credit profile on BPA. The outlook is stable.

Bond proceeds will fund \$200 million of ENW's CGS capital projects and the balance will refund portions of ENW's existing debt.

Although the Project 3 bonds are subordinate ENW obligations, the utility covenanted to close the prior lien. The \$178.5 million of closed-lien senior debt represents about 3% of the \$5.5 billion of ENW debt that BPA supports. ENW has retired its prior-lien Columbia Electric Revenue bonds.

At fiscal year-end 2013 (Sept. 30), BPA had \$15.0 billion of debt obligations, consisting of \$4.3 billion of federal appropriations, \$3.9 billion of bonds issued to the U.S. Treasury, and \$6.8 billion of nonfederal debt that Bonneville supports. BPA pays nonfederal debt from net revenues before it services federal Treasury debt and appropriations.

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 (84% of sales), to federal agencies, direct service industries and the residential and farm customers of six investor-owned utilities. BPA also operates an extensive transmission system that facilitates

power marketing activities. Its transmission system represents about 75% of the Pacific Northwest's transmission capacity.

The 'AA-' ratings on ENW's debt and the other nonfederal debt that BPA supports reflect BPA's contractual obligations to support the debt and the application of our government-related entities criteria (GRE). We believe that Bonneville's stand-alone credit profile is 'aa-' and there is a "moderately high" likelihood that the U.S. government would provide extraordinary support to it in financial distress. We base the latter view on our opinion of the "strong" link between the BPA 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 of 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;
- Legislation that allows BPA to defer repayments of federal obligations if in financial distress; and
- The utility's important contributions to the Pacific Northwest's economy, where it indirectly serves a population of about 12 million in eight states, provides low-cost 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 the following factors:

- The ongoing support the federal government provides to BPA through loans and credit lines;
- Congress's 2009 increase in the agency's federal borrowing authority to \$7.70 billion, up \$3.25 billion (or 73%). However, Bonneville projects that by 2017, it could consume the headroom between its \$3.9 billion of U.S. Treasury borrowings and \$7.7 billion as it proceeds with those years' \$3.2 billion of capital spending. BPA is exploring off-balance-sheet financing structures to increase its borrowing capacity and avoid reaching the federal limits. Even with recent years' use of off balance sheet alternatives, the utility's Treasury debt has nearly doubled since the end of 2009;
- The legislative mechanism that allows BPA to pay nonfederal debt as an operating expense ahead of federal debt service and to defer repaying federal obligations if it lacks the financial resources to meet all of its operating and debt obligations;
- A track record of at least 1.8x nonfederal debt service coverage in fiscal years 2009-2013, tempered by accrual coverage of total obligations of 1.0x in 2011 and 2013, 0.8x in 2009 and 2010, and 0.9x in 2012;
- Robust liquidity, which tempers the sometimes substantial impacts of variable hydrology conditions on financial performance and mitigates credit risks inherent in biennial rate cases;
- The utility's exceptionally broad and diverse service territory serving a population of about 12 million people in portions of eight states;
- The strong, efficient, and economical operations of the federal hydroelectric Columbia River Power System, which foster strong demand for their output and ENW nuclear production;
- Contracts between BPA and its customers that extend from 2008-2028, which demonstrate the customer base's commitment to the agency's system. However, the new contracts do not establish rates and the utility continues to rely on rate proceedings; and
- Tiered rates that underlie the customer contracts and help shield BPA from market volatility by assigning to

customers the costs of energy needs exceeding individual allotments of capacity from the federal hydroelectric projects and CGS.

Standard & Poor's also incorporates the following exposures in its assessment:

- Financial performance hinges on hydrology conditions that can impair surplus power sales revenues and can require replacement power purchases that add to expenses. Due to poor hydrology, accrual-basis debt service coverage of nonfederal and federal debt was only 0.8x in 2009 and 2010, and 0.9x in 2012. BPA's cash from operations was \$268 million in 2009 and \$370 million in 2010, representing the lowest points in cash from operations since 2007's \$872 million. However, we believe robust liquidity provided a cushion that tempered the financial implications of weak hydrology.
- Highly politicized and protracted biennial rate proceedings can delay rate relief and constrain the benefits of autonomous ratemaking authority and financial flexibility. BPA is awaiting final Federal Energy Regulatory Commission (FERC) approval of its 2014-2015 rates. Pending this approval, the rates are in effect on a preliminary basis; municipal and cooperative customers' 2014-2015 electric rates are 9% higher than previous rates and transmission rates are 11% higher.
- Bonneville and ENW project substantial capital needs that could add to both organizations' debt and consume BPA's Treasury borrowing authority. The utility reports it is exploring off-balance-sheet financing arrangements, including leases and energy prepayments by its customers to address expectations that it could soon exhaust its federal borrowing capacity.
- The \$7.7 billion federal debt limit includes \$750 million carved out as a credit line, which leaves \$3 billion of capacity after existing borrowings.

The agency's federal debt includes bonds issued to the U.S. Treasury and federal appropriations that Bonneville must repay with interest. The nearly 1-to-1 ratio of nonfederal-to-federal debt facilitates what we consider sound debt service coverage of the nonfederal bonds as long as rates meet all financial obligations.

Outlook

The stable outlook reflects our view that Bonneville's stand-alone credit profile can withstand a further downgrade on the U.S. Also, unless FERC denies final approval of the 2014-2015 rates, we believe the 9% power rate increase and 11% transmission rate increase established in BPA's rate proceeding covering the two fiscal years that began in October 2013 could help support debt service coverage and liquidity as the utility faces weak hydrology conditions and soft wholesale power markets. If during our two-year outlook horizon, Bonneville's robust liquidity cushion meaningfully erodes, we could lower the stand-alone credit profile. Also, if BPA adds significant off-balance-sheet leverage obligations because of its statutory debt ceiling, it could lead to negative implications for the stand-alone credit profile and the 'AA-' rating. We do not expect to raise the ratings in the next two years.

Bonneville's Nonfederal Debt Obligations

BPA's nonfederal rated obligations include:

- \$5.5 billion of ENW revenue and refunding bonds;
- \$87.9 million of Public Utility District No. 1 of Lewis County, Wash., Cowlitz Falls Project bonds;

- \$119.6 million of Northwest Infrastructure Financing Corp. (Schultz-Wautoma project) bonds;
- \$18.4 million of Northern Wasco Public Utility District, Ore. (McNary Dam Project) bonds;
- \$3.0 million of conservation and renewable energy system bonds; and
- \$3.5 million of Tacoma, Wash., conservation system project bonds.

Through the Northwest Infrastructure Financing Corp., which developed transmission assets financed through lease arrangements, BPA also has borrowed \$598.2 million on credit lines as of Feb. 28, 2014.

Capital Spending Forecast

Bonneville projects nearly \$5 billion of 2014-2018 capital projects. In descending order, transmission projects, hydroelectric asset upkeep, energy efficiency projects and fish and wildlife protection represent the largest segments of the capital program. ENW projects about \$612 million of capital projects during these years.

Operations

In fiscal 2013, federal hydroelectric projects supplied about 87% of the electricity that Bonneville sold. ENW's CGS supplied about 10% and the balance came from other non-federal projects.

ENW debt financed two partially completed nuclear reactors and one completed reactor, CGS, a 1,150 MW reactor. Dividing nonfederal debt service by the kilowatt-hours (kWh) from nuclear capacity and other nonfederal assets produces an average nonfederal assets debt service per kWh that is about 10x more expensive than the federal hydroelectric assets' debt service per kWh. The nuclear assets' debt is the leading component of nonfederal obligations.

Related Criteria And Research

Related Criteria

- USPF Criteria: Electric Utility Ratings, June 15, 2007
- General Criteria: Rating Government-Related Entities: Methodology And Assumptions, Dec. 9, 2010

Ratings Detail (As Of March 27, 2014)

Conservation and Renewable Energy Sys, Washington

Bonneville Pwr Admin, Oregon

Conservation & Renewable Energy Sys (Bonneville Pwr Admin) conserv proj

<i>Long Term Rating</i>	AA-/Stable	Affirmed
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Energy Northwest, Washington

Bonneville Pwr Admin, Oregon

Energy Northwest elec rev rfdg bnds

<i>Long Term Rating</i>	AA-/Stable	Affirmed
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Energy Northwest proj 1 Columbia generating station & proj 3 elec rev rfdg bnds (Bonneville Pwr Admin)

<i>Long Term Rating</i>	AA-/Stable	Affirmed
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Energy Northwest proj 1, Columbia Generating Sta, & proj 3 elec rfdg

Ratings Detail (As Of March 27, 2014) (cont.)		
<i>Long Term Rating</i>	AA-/Stable	Affirmed
Energy Northwest (Bonneville Pwr Admin) elec rev rfdg bnds (Proj 1 taxable)		
<i>Long Term Rating</i>	AA-/Stable	Affirmed
Energy Northwest (Bonneville Pwr Admin) elec rev rfdg bnds (Proj 1)		
<i>Long Term Rating</i>	AA-/Stable	Affirmed
Energy Northwest (Bonneville Pwr Admin) proj 3 elec rev rfdg bnds var rate subseries F-1 (Bonneville Pwr Admin) ser 2008-F dtd 06/17/2008 due 07/01/20		
<i>Long Term Rating</i>	AA-/Stable	Affirmed
Energy Northwest (Bonneville Pwr Admin) rfdg rev bnds (Bonneville Pwr Admin-Nuclear Proj #1 & #3) ser 1993C dtd 09/01/1993 due 07/01/1996 1999 2002-20		
<i>Unenhanced Rating</i>	AA-(SPUR)/Stable	Affirmed
Energy Northwest (Bonneville Pwr Admin) Columbia generating station elec rev bnds		
<i>Long Term Rating</i>	AA-/Stable	Affirmed
Energy Northwest (Bonneville Pwr Admin) Sub Lien		
<i>Long Term Rating</i>	AA-/Stable	Affirmed
Energy Northwest (Bonneville Pwr Admin) (Nuclear Proj 1,2,3)		
<i>Long Term Rating</i>	AA-/Stable	Affirmed
Energy Northwest (Bonneville Pwr Admin) (1,Columbia,3)		
<i>Long Term Rating</i>	AA-/Stable	Affirmed
Bonneville Pwr Admin elec		
<i>Unenhanced Rating</i>	AA-(SPUR)/Stable	Affirmed
Bonneville Pwr Admin elec rev rfdg (Colu)		
<i>Unenhanced Rating</i>	AA-(SPUR)/Stable	Affirmed
Energy Northwest rfdg elec rev bnds (Bonneville Pwr Admin)		
<i>Unenhanced Rating</i>	AA-(SPUR)/Stable	Affirmed
Energy Northwest (Bonneville Pwr Admin)		
<i>Unenhanced Rating</i>	AA-(SPUR)/Stable	Affirmed
Energy Northwest (Bonneville Pwr Admin) (XL Capital Assurance Inc.)		
<i>Unenhanced Rating</i>	AA-(SPUR)/Stable	Affirmed
Washington Pub Pwr Supp Sys (Nuclear Proj #3) rfdg rev bnds ser 93C dtd 9/23/93 due 7/1/2013 2014 2015 2017(CUSIP #939830RW7 RY3 RX5 RZ0)		
<i>Unenhanced Rating</i>	AA-(SPUR)/Stable	Affirmed
Washington Pub Pwr Supp Sys (Nuclear Proj #3) (Bonneville Pwr Admin)		
<i>Unenhanced Rating</i>	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)		
<i>Long Term Rating</i>	AA-/Stable	Affirmed
Northern Wasco Cnty Peoples Util Dist (Bonneville Pwr Admin) (McNary Dam Fishway Hydroelec Proj)		
<i>Long Term Rating</i>	AA-/Stable	Affirmed

Ratings Detail (As Of March 27, 2014) (cont.)

Northwest Infrastructure Financing Corp., New York

Bonneville Pwr Admin, Oregon

Northwest Infrastructure Financing Corp. (Bonneville Pwr Admin) TRAns

<i>Long Term Rating</i>	AA-/Stable	Affirmed
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Tacoma, Washington

Bonneville Pwr Admin, Oregon

Tacoma (Bonneville Pwr Admin) (Pub Util Lt Div Conserv Sys Proj)

<i>Long Term Rating</i>	AA-/Stable	Affirmed
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Many issues are enhanced by bond insurance.

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