FitchRatings

RATING ACTION COMMENTARY

Fitch Rates Port of Morrow, OR Trans Facilities Rev Bonds 'AA'; Outlook Revised to Stable

Tue 24 Nov, 2020 - 2:38 PM ET

Fitch Ratings - Austin - 24 Nov 2020: Fitch Ratings has assigned a 'AA' rating to the following transmission facilities revenue bonds issued by the Port of Morrow, Oregon and secured by lease payments from the Bonneville Power Administration (Bonneville):

--Approximately $200 million transmission facilities revenue bonds (Bonneville Cooperation Project No. 8), series 2020-2 (taxable).

The 2020-2 bonds are scheduled to price on Dec. 9, 2020, via negotiation. Bond proceeds will refinance existing bank loans used to finance transmission assets and pay costs of issuance.

Fitch has affirmed the 'AA-' Issuer Default Rating (IDR) of the Bonneville Power Administration. The IDR reflects the credit quality of Bonneville's repayment of all its fixed obligations, including federal and nonfederal debt and lease obligations.

Fitch has also affirmed the 'AA' debt ratings on the following nonfederal debt, which is secured on parity through payments from Bonneville:

--$778.4 million Energy Northwest (ENW) Project 1 revenue bonds.

--$3.04 billion ENW Columbia Generating Station revenue bonds.

--$912.0 million ENW Project 3 revenue bonds.

--$200.8 million Idaho Energy Resources Authority transmission facilities revenue bonds, series 2017.

--$1.2 billion Port of Morrow transmission facilities revenue bonds, series 2012, 2014, 2015, 2016-1, 2016-2, 2019 and 2020-1.

--$68.5 million Lewis County Public Utility District No. 1 Cowlitz Falls hydroelectric project revenue refunding bonds, series 2013.

The ratings on the nonfederal debt listed above and issued by Energy Northwest, Idaho Energy Resources Authority, Port of Morrow and Lewis County Public Utility District (PUD) No. 1 reflect Bonneville's unconditional obligation to pay debt service, as well as structural security features specific to the priority of these obligations ahead of Bonneville's federal debt (approximately $5.6 billion in U.S. Treasury debt and $1.2 billion federal appropriations debt as of Sept. 30, 2020).

The Rating Outlook on all ratings has been revised to Stable from Negative.

Analytical Conclusion

The revision of the Outlook to Stable reflects strong financial performance in fiscal 2020, which strengthened Bonneville's previously weak liquidity profile. Despite the economic and coronavirus-related challenges of fiscal 2020, Bonneville ended the year with lower than budgeted expenditures and higher than budgeted surplus revenues, due to favorable late summer water conditions and production at the hydroelectric assets. As a result, Bonneville's total cash reserves increased to the highest point in the last five years.

The increase in cash reserves addresses liquidity concerns, which had triggered the Negative Outlook in June 2020, after Bonneville suspended its financial reserves policy (FRP) surcharge in response to the pandemic. The FRP was adopted in 2019 to enhance Bonneville's financial flexibility over a multiyear period, and improve its ability to respond to volatility, whether hydrological, power market related or economic. The outperformance of the budget in 4Q fiscal 2020 resulted in a larger increase to reserves than would have occurred had the FRP surcharge remained in place during the final three months of fiscal 2020. Following the stronger than expected results, Bonneville ended fiscal 2020 in compliance with the minimum 60-day cash on hand target outlined by the FRP, with total reserves available for risk (Bonneville's term for its unrestricted cash) equal to 113 days.

Bonneville's 'AA-' Issuer Default Rating (IDR) reflects very strong revenue defensibility and very low operating costs, which support the utility's financial profile assessment of 'aa'. Bonneville's leverage ratio, measured by net adjusted debt to funds available for debt service (FADS), exhibits a degree of volatility. Notwithstanding expectations that hydrological variability could result in net secondary revenues that fall below budget periodically, driving leverage higher, Fitch expects leverage to remain mostly below 10.0x over the next five years. Leverage declined to 9.3x in fiscal 2020, down from 11.4x in 2020, with the decline driven by improved FADS and higher reserve levels.

The 'AA' ratings on the nonfederal debt obligations - distinct from Bonneville's 'AA-' IDR - further reflect Bonneville's unconditional obligation to make those payments ahead of its federal debt. Bonneville's federal obligations include the structural ability to defer debt repayments and interest due in the event Bonneville's revenues are insufficient following the payment of Bonneville's other obligations, including the nonfederal debt.

Coronavirus Impact Limited

The coronavirus pandemic and related government containment measures have had limited impact on Bonneville's credit profile to date. Overall load impacts have been modest; commercial and industrial declines have been replaced by residential load increases. However, pressure continues, including new economic closures in Washington and Oregon announced this week due to resurgence of the coronavirus, and will likely have a varying degree of impact across Bonneville's broad service area. Fitch's ratings remain forward-looking in nature and Fitch will continue to monitor developments related to the severity and duration of the pandemic.

SECURITY

Bonneville's lease payments to Port of Morrow for debt service on the bonds are an absolute and unconditional payment obligation made from the Bonneville Fund.

All of Bonneville's revenues are required to be deposited in the Bonneville Fund, which is a separate fund within the U.S. Treasury. Expenditures from the Bonneville Fund do not require further federal appropriation. The nonfederal debt obligations are consolidated as obligations on Bonneville's financial statements and are paid prior to Bonneville's payments on its borrowings from the U.S. Treasury and federal appropriations debt.

KEY RATING DRIVERS

Revenue Defensibility: 'aa'; Geographic and Operational Revenue Diversity

Bonneville's revenue defensibility is very strong. Long-term power sales contracts with over 125 customers and Bonneville's dominant role as the regional transmission provider, result in long-term revenue security, notwithstanding some degree of renewal risk related to the power supply contracts, which is considered an asymmetric rating consideration.

Bonneville establishes its own rates, although rate flexibility is constrained by a lengthy and rigid process. The purchaser credit quality of Bonneville's wholesale customers is strong. The largest customers exhibit favorable service area characteristics and very strong financial profiles.

Operating Risk: 'aa'; Very Low-Cost Hydroelectric Power Supply

Bonneville's operating cost burden is low at 3.4 cents per kilowatt hour (kwh) in fiscal 2020, largely due to a low-cost, predominantly hydroelectric generation fleet. Capital needs are considered moderate but total $4.6 billion over the next five years and relate to reinvestment in aging generation assets and transmission investment across the six-state service area.

Financial Profile: 'aa'; Highly Leveraged; Strong Sales Improved Liquidity in Fiscal 2020

Bonneville's financial performance in fiscal 2020 exceeded budget expectations, and the liquidity profile is no longer considered weak. Given planned capital spending and debt issuance, Fitch expects Bonneville's leverage ratio to decline to the 9.0x-10.0x range over the next five years, although leverage could periodically increase to 11.0x under adverse water conditions. Transmission business lines are able to support slightly higher leverage than the power business line, resulting in Fitch's tolerance for leverage trending slightly higher than the 10.0x 'aa' threshold given Bonneville's revenue defensibility and operating risk assessments. Coverage of full obligations is around 1.0x.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

--Material declines in leverage.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

--Leverage trending consistently above 11.0x with limited expectation of reduction;

--Dilution of revenue defensibility over the medium term that reduces Bonneville's ability to support existing leverage at the current rating. The potential for dilution could occur from reductions in load or more permissive contract terms that might emerge during the contract-renewal process.

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Sovereigns, Public Finance and Infrastructure issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of three notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit [https://www.fitchratings.com/site/re/10111579].

CREDIT PROFILE

The Port of Morrow is a port district located in Morrow County, Oregon. The port has the legal 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, prior to the first lease transaction executed with Bonneville. According to the terms of multiple lease agreements between the Port of Morrow and Bonneville, Bonneville makes unconditional lease payments directly to the trustee (the port has assigned the lease revenues to the trustee) that are equal to debt service on outstanding bonds, including the series 2020-2 bonds. Bonneville retains operational control of the transmission assets.

Energy Northwest (ENW) owns and operates the Columbia Generating Station (CGS), the Packwood Lake Hydroelectric Project and the Nine Canyon Wind Project. ENW also has financial responsibility for Projects 1 and 3, its terminated nuclear projects. Bonneville is responsible for the repayment of certain ENW costs, including debt service, related to CGS and Projects 1 and 3 through the terms of net billing agreements. Bonneville pays CGS, Project 1 and Project 3 costs to ENW under a direct-pay agreement. The direct-pay agreement permits ENW net billing participants - Bonneville's preference customers - to purchase power from and make payments directly to Bonneville without making net billing payments to ENW to receive bill credits from Bonneville, as outlined under the net billing agreements.

Bonneville provides wholesale power to a population of more than 14 million in the Pacific Northwest through a resource portfolio consisting of low-cost hydropower and nuclear generation. Transmission services are provided to a similar six-state region, but to a broader number of utilities. Bonneville is the largest of four federal power-marketing administrations within the U.S. Department of Energy. Bonneville's predominantly hydroelectric generation portfolio--86% of total owned capacity--results in hydrology risk and a variable energy supply.

Low market energy prices in the region place practical competitive pressure on Bonneville to keep rate increases as low as possible and drove Bonneville's net secondary revenues (short-term sales made outside its long-term contracts) lower over the past decade. These factors coupled with declining power demand from Bonneville's preference customers resulted in a tightening of Bonneville's financial profile over the same period.

Increased Reserves

Bonneville's total cash reserves improved at the end of fiscal 2020 to $889 million, Fitch-calculated days cash on hand (DCOH) of 148 days, up from 116 DCOH in fiscal 2019. The portion of this amount considered by Bonneville as 'reserves available for risk', or unrestricted cash, was $708 million up from $485 million at the end of fiscal 2019. Importantly, the power business line's share of reserves available for risk increased significantly to $435 million (95 DCOH) from $203 million (40 DCOH) in fiscal 2019.

Cash reserves play a key role in managing aspects of Bonneville's revenue variability related to hydrology risk and wholesale energy sales. The trajectory and pace of declines between 2015 and 2018 in the power business line reserves available for risk were an ongoing weakness that contributed to Bonneville's decision to adopt the FRP. Prior declines in power business line reserves resulted from the underperformance of net secondary sales and declining preference customer load. The increase in fiscal 2020 resulted from revenue and expenditure trends that were favorable to budget. Power and transmission business line reserves are comingled in the Bonneville Fund but tracked independently for rate setting purposes.

For additional information, see Fitch's report, "Bonneville Power Administration, OR," expected to be released the week of Nov. 30, 2020.

SUMMARY OF FINANCIAL ADJUSTMENTS

Fitch adjusts Bonneville's cash reserves to include delayed borrowing from the U.S. Treasury for certain capital expenditures, primarily for fish and wildlife. Cash reserves are additionally reduced by funds held at the U.S. Army Corps of Engineers and Bureau of Reclamation for planned expenditures.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG CONSIDERATIONS

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

RATING ACTIONS

ENTITY/DEBT	RATING			PRIOR
Bonneville Power Administration (OR)	LT IDR	AA- Rating Outlook Stable	Affirmed	AA- Rating Outlook Negative
• Bonneville Power Administration (OR) /Issuer Default Rating/1 LT	LT	AA- Rating Outlook Stable	Affirmed	AA- Rating Outlook Negative
• Bonneville Power Administration (OR) /Transmission Revenues/1 LT	LT	AA Rating Outlook Stable	Affirmed	AA Rating Outlook Negative

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

Public Sector, Revenue-Supported Entities Rating Criteria (pub. 27 Mar 2020) (including rating assumption sensitivity)

U.S. Public Power Rating Criteria (pub. 30 Mar 2020) (including rating assumption sensitivity)

APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

FAST Public Power - Fitch Analytical Stress Test Model, v1.1.3 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Bonneville Power Administration (OR)	EU Endorsed
Energy Northwest (WA)	EU Endorsed
Idaho Energy Resources Authority (ID)	EU Endorsed
Lewis County Public Utility District No. 1 (WA)	EU Endorsed
Port of Morrow (OR)	EU Endorsed

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Utilities and Power   US Public Finance   North America   United States