Public Power/North America
New Issue

Energy Northwest
(Bonneville Power Administration)

Ratings

New Issues

$52.145 Mil. Project 1 Electric Revenue Refunding Bonds, Series 2007-A......................AA–
$78.175 Mil. Columbia Generating Station Electric Revenue Refunding Bonds, Series 2007-A.........AA–
$84.955 Mil. Project 3 Electric Revenue Refunding Bonds, Series 2007-A......................AA–
$6.635 Mil. Project 1 Electric Revenue Refunding Bonds, Series 2007-B (Taxable).....AA–
$5.600 Mil. Columbia Generating Station Electric Rev. & Refunding Bonds, Series 2007-B (Taxable).........AA–
$1.695 Mil. Project 3 Electric Revenue Refunding Bonds, Series 2007-B (Taxable).......................AA–
$219.020 Mil. Project 1 Electric Revenue Bonds, Series 2007-C..AA–
$61.085 Mil. Project 3 Electric Revenue Refunding Bonds, Series 2007-C......................AA–
$39.945 Mil. Columbia Generating Station Electric Revenue Bonds, Series 2007-D ....AA–

Outstanding Debt

Security Class	Current Rating	Previous Rating	Date Changed
Proj. 1 Prior Lien	AA–	AA	3/12/03
Proj. 1 Revenue	AA–	AA	3/12/03
Columbia Prior Lien	AA–	AA	3/12/03
Columbia Rev.	AA–	AA	3/12/03
Proj. 3 Prior Lien	AA–	AA	3/12/03
Proj. 3 Revenue	AA–	AA	3/12/03

Rating Watch...None
Rating Outlook..Positive

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Key Credit Strengths

- Competitive power supply.
- Largest provider of electricity and transmission in the Pacific Northwest.
- ENW debt service paid prior to U.S. Treasury payments.
- Improved financial performance.

Key Credit Concerns

- Volatility associated with hydro system.
- Exposure to wholesale market.
- Political and litigation uncertainty regarding rates and fish conservation.
- Funding source for ongoing capital needs.

March 16, 2007

■ Profile

Energy Northwest (ENW), formerly the Washington Public Power Supply System, has 20 members, consisting of 17 public utility districts and the cities of Richland, Seattle and Tacoma, Wash. ENW owns and operates the Columbia Generating Station (CGS).

Bonneville Power Administration (BPA) is obligated to pay debt service on ENW bonds. BPA is the largest of the regional federal power marketing agencies within the U.S. Department of Energy (DOE). BPA sells and/or exchanges power with more than 100 utilities in the region and with certain industrial customers under contracts that expire in 2011. The service area spans 300,000 square miles in the Pacific Northwest and accounts for approximately 35% of the electric power consumed in the region. BPA also owns and operates a transmission system comprising approximately 75% of the bulk transmission capacity in the Pacific Northwest.

■ Rating Rationale

The ‘AA–’ rating is reflective of BPA’s position as a leading provider of electricity and transmission in the Pacific Northwest and its highly competitive wholesale power rates. Credit concerns include the risk inherent in a hydro-based system where available energy and wholesale costs are dependent on weather conditions. Additional risks involve regional political differences among BPA’s stakeholders, ongoing potential for greater fish protection expenditures and the expectation that BPA will reach its borrowing cap in the next 10 years.

The Positive Rating Outlook reflects BPA’s continuing and favorable progress in reaching power sale agreements with its customers for the period beyond 2011. BPA’s proposed terms would create greater long-term certainty for its rates and encourage its members to meet their growing needs and/or pay for incremental costs to BPA. In addition, the Rating Outlook revision is due to the improved financial profile, the implementation of an adequate cost-recovery adjustment mechanism and a favorable outlook for its surplus energy sales and cost competitiveness, given current and forecasted wholesale energy prices. If BPA continues to move closer toward finalizing contract terms and maintains consistently strong financial performance, a rating upgrade to ‘AA’ is attainable in the next 12–18 months.

■ Security and New Issue Summary

Fitch assigned an ‘AA–’ rating to ENW’s aggregate $549 million 2007 series A, B, C and D electric revenue bonds. Fitch also affirmed ENW’s outstanding $1.8 billion prior-lien bonds and $3.8 billion revenue bonds issued in connection with Project 1, CGS and Project 3. Fitch revised the Rating Outlook to Positive from Stable.

The 2007A–D financings consist of taxable and tax-exempt bonds and involve the three projects mentioned previously. The 2007 bonds are payable on a subordinate basis to outstanding ENW prior-lien bonds. The prior-lien resolution was previously closed. BPA is obligated to pay debt service on ENW's Project 1, CGS and Project 3 bonds.

The series 2007A–D bonds are being issued to refund certain prior-lien and revenue bonds issued by ENW in connection with Project 1, CGS and Project 3 and finance capital expenditures for CGS. The series 2007A–D bonds are scheduled to price the week of March 19, 2007, with Citigroup Inc. as senior manager for series 2007A, B and D bonds and Goldman Sachs & Co. as the senior manager for the series 2007C bonds.

Recent Developments

Continued Progress on Post-2011 Contracts

For the past 18 months, BPA has been working with its customers on long-term contracts. BPA's proposed terms would create greater long-term certainty for its rates and encourage its members to meet their growing needs and/or pay for incremental cost to BPA.

In September 2005, BPA issued a "concept paper" that described its proposal on all key post-2011 issues relating to new contracts. BPA published a formal proposal in the Federal Register and issued it for comment. BPA has since received several comments from its customers and plans to respond to those comments through a final policy to be issued in the coming months. Taking those comments into consideration, BPA looks to have contracts signed by the fall of 2008. Key elements of the proposal include:

- 20-year contracts (longer than the current 10-year contracts).
- Rate methodology that would restrict the amount of power of preference customers that may purchase at the lowest rate equal to the output of the existing federal system (tier 1).
- Allocation would be based on the customers' 2010 energy needs.
- Incremental purchasers would be sold at a higher rate, reflecting the cost of incremental load (tier 2).
- A settlement agreement with regional investor-owned utilities (IOUs) that would provide annual benefits comparable to the existing arrangement.

Third-Party Financing

Despite the accelerated paydown of current obligations to the U.S. Treasury, BPA is expected to reach its borrowing cap (established by Congress) in the next 10 years. BPA is authorized by Congress to issue $4.45 billion of bonds to the U.S. Treasury ($1.25 billion must be for renewable resource loans and grants). BPA currently has approximately $2 billion in debt capacity remaining.

The President's current U.S. budget proposal allows for third-party lease purchase financings not to count against BPA's U.S. Treasury borrowing cap. BPA plans to utilize this structure as much as possible during 2007 and subsequent years where it has this option. With 2007 lease purchase financings, BPA estimates that it would be able to maintain borrowing capacity until 2018.

Over the long term, an essential component of BPA's credit will be its continued ability to fund the increasing capital needs for transmission, conservation and renewable resources and maintain the existing system.

Enhanced Liquidity Mechanisms

BPA recently negotiated with some of its customers for the ability to temporarily increase its rates with a 10-day notice and receive funds within 35–45 days. This arrangement could provide BPA with up to $194 million under certain stress scenarios. This strategy, in combination with direct payments from ENW customers (enacted last year) enhances BPA's financial position and allows it to ultimately provide lower rates (5%–10%) than what the rates otherwise would have been to its customers.

Partial Loss of Wholesale Sale Revenues

The current federal budget proposal requires BPA to make early payments on its federal debt from any BPA surplus sales in excess of $500 million. At this time, it is uncertain if this proposal will be implemented. This proposal was originally introduced in 2006, but its implementation was delayed by a Congressional act. If the current budget proposal is implemented, it could cause an increase in BPA's rates.

Continued Fish Preservation Litigation

Management expects the direct cost component of its fish preservation to remain constant over the upcoming years. BPA spent approximately $852 million on fish and wildlife preservation in fiscal-year 2006, which includes both direct costs (actual dollars spent) and replacement power costs (foregone revenues from power sales). While the direct cost has been relatively constant, the aggregate cost of fish preservation in 2006 was substantially higher than in recent years ($576 million in 2005). The increase was a result of higher forgone power revenues due to greater hydro conditions and higher profit margins from off-system sales. Fitch believes BPA's financial position and credit profile is sufficient to mitigate these financial pressures.

Currently, there are legal challenges that seek to breach (dismantle) some of the federal hydro facilities to enhance salmon preservation. The consequences of that proposal would be significant. BPA and its general counsel believe that legislation from Congress would be needed to breach the federal dams.

■ ENW

ENW has 20 members, consisting of 17 public utility districts and the cities of Richland, Seattle and Tacoma, Wash. ENW owns and operates a nuclear generating station, CGS, with a net design rating of 1,153 megawatts (mw), the Packwood Lake Hydroelectric Project and the Nine Canyon Wind Project. CGS is licensed to operate into 2023.

Fitch views CGS as a reliable and low-cost generating unit. During 2006, CGS set a performance record of more than 400 days of continuous on-line operations. The price of CGS electricity was 2.1 cents/kilowatt-hour (kwh) during fiscal-year 2006. ENW is working on a proposal to extend CGS' 40-year operating license by 20 years to 2043 from 2023. Current balances in ENW's decommissioning and site restoration trust funds are considered adequate at this time.

■ BPA

With more than $3.4 billion in revenues and more than 9,000 mw of firm capacity, BPA is the largest regional federal power marketing agency within the DOE. In 1996, BPA separated its power marketing function from its transmission system operation and electric system reliability functions. BPA remains a single legal entity, but it now conducts its businesses as separate business lines: the power business line and the transmission business line.

Power Supply

BPA's power supply is hydro-based (90% of energy) and derives from 31 federally owned hydroelectric projects and several non-federally owned and operated projects, including ENW's nuclear-based CGS. The hydro project's low cost (especially relative to the increasing natural gas-based wholesale market) is the foundation for BPA's high credit rating.

Most hydro projects are located in the Columbia River Basin (approximately 9,000 average mw under medium water conditions). These resources are referred to as the federal system. The hydro projects were constructed and are operated by the U.S. Army Corps of Engineers or the Bureau of Reclamation.

Fiscal-year 2006 was the first year since 1999 that BPA experienced an above-average water flow. The outlook for fiscal-year 2007 is for slightly below-average (94% of 30-year average) hydrological conditions.

Transmission

The federal transmission system is composed of approximately 15,000 circuit miles of high-voltage transmission lines and more than 300 substations that are located in Washington, Oregon, Idaho and parts of Montana, Wyoming and northern California. A southern intertie interconnects the electric systems of the Pacific Northwest and Pacific Southwest and allows for broader regional sales by BPA. The rated transfer capability of the southern AC intertie in the north-to-south direction is 4,800 mw of capacity and is 3,675 mw in the south-to-north direction. The rated transfer capability of the DC line in both directions is 3,100 mw.

■ BPA Service Area and Customers

BPA's primary customer service area is the Pacific Northwest region of the United States, encompassing Idaho, Oregon, Washington, parts of western Montana, and small parts of western Wyoming, northern Nevada and northern California. BPA sells electric power in a 300,000 square-mile service area and services a total population of approximately 11 million people.

BPA sells and/or exchanges power with more than 100 utilities in the region and with several industrial customers through contracts that expire in 2011. BPA has four major customer classes:

- Preference customers, which account for 50% of electric sale revenues, include municipal utilities, public utility districts and rural electric cooperatives.

- Regional IOUs, which account for 15% of electric sale revenues, include BPA's low-cost power supply benefits to the residential and small-farm customers of six regional IOUs. BPA and the IOUs agreed to a settlement that satisfies BPA's obligation through financial payments through 2011 (approximately $100 million–$300 million per year).
- Regional customers, which account for 20% of electric sale revenues, consist of surplus firm and nonfirm power sales primarily to California utilities.
- Direct service industries (DSIs), which account for 2% of electric sale revenues, include electric sales directly to aluminum and processing facilities.

The Northwest Power Act requires BPA to meet certain firm loads in the Northwest of various preference customers and regional IOUs. BPA does not have an obligation to meet all firm loads within the region or enter into contracts to sell any power to DSIs.

■ BPA Preference Customers

BPA sells preference customers four basic power products.

- Block sales, under which BPA provides five-year fixed blocks of power at agreed times on a take-or-pay basis.
- Slice of the system, which is a form of requirements service in which BPA sells a proportion of federal system output, both firm power and seasonal surplus energy, in return for a promise of the customer to pay a correlative proportion of the cost of the federal system.
- Partial-requirement sales.
- Full-requirement sales.

Under these agreements, BPA is obligated to provide approximately 7,200 average mw to meet preference customer loads through fiscal-year 2011. Of this amount, approximately 1,600 average mw is sold as slice of the system products, approximately 2,200 average mw is in the form of block sales, and the remainder (3,400 mw) is in the form of full- or partial-requirement products.

■ BPA Rates

BPA's rates are subject to extensive review by outside parties, which differentiates BPA's credit from most those of other municipal wholesale utilities that are self-regulated. Rates proposed by BPA are reviewed by the Federal Energy Regulatory Commission (FERC). After FERC approval, rates may be reviewed by the U.S. Court of Appeals. Actions seeking such review must be filed within 90 days of the final FERC decision.

Power Supply Rates

BPA recently enacted new rates for fiscal-years 2007–2009. The base preference rate was 2.7 cents/kwh, a slight decrease relative to recent years (2.9–3.0 cents/kwh). The most significant change involved the use of an annual adjustment trigger based on accumulated power revenues. While the rate-adjustment mechanism is not as frequent as its prior structure, Fitch believes the triggers (along with a strong cash reserve base) are sufficient to meet reasonable stress scenarios. Regarding wholesale power rates for 2010 and 2011, BPA will begin discussions with customers in 2008 and request FERC approval of its proposed rates in 2009.

Transmission Rates

In October 2005, BPA enacted a 12.5% rate increase for transmission rates for two years. This increase translates into a 1%–2% overall rate increase. The reason for the increase was a shortfall of transmission sales and additional costs associated with reliability projects. BPA is currently evaluating rates for 2008–2009 and does not expect transmission rates to increase (due to higher expected usage and additional revenues from related ancillary services). Transmission rates for 2010–2011 will be established jointly with power rates as previously mentioned.

■ BPA Finances

BPA's finances have stabilized over the past few years. Modified net revenues (which are a more accurate measure of operational margins than net revenues) show a steady increase over the past three years. Modified net revenues for fiscal-year 2006 were $445 million, compared with $126 million and $66 million for fiscal-years 2005 and 2004, respectively.

In fiscal-year 2006, BPA's debt-service coverage for its ENW obligations (both prior-lien and revenue bond lien) was more than 4.9 times (x). Coverage of all ENW and Treasury obligations, however, was

1.26x. It is important to note that BPA's payment obligation of ENW debt service is senior to its obligation on Treasury obligations. If BPA does not have sufficient funds to meet its Treasury obligations in a given year, the payment obligation would be deferred to the following year. Not since 1983 has BPA deferred its payments to the U.S. Treasury.

In addition, for fiscal year-end 2006, BPA had approximately $1.2 million in financial reserves, which is equal to six months of operating expenses. Of that amount, $250 million was a result of temporary cash infusion as a result of BPA's new direct pay cash flow.

Despite the cash flow coverage and strong cash reserves, Fitch recognizes that BPA is highly leveraged, especially relative to other public power wholesale systems, such as joint-action agencies and generation and transmission cooperatives. BPA's equity-to-capitalization (13%) and debt-to-funds available for debt service (8.0x) are indicative of above-average leverage and heavy reliance on debt to fund ongoing capital needs. Partially mitigating this concern are BPA's improving leverage indicators, low rates, cash reserves and the senior position of ENW's debt.

Financial Summary — Bonneville Power Administration

($000, Years Ended Sept. 30)

	2006	2005	2004	2003
Cash Flow				
Non-Federal Projects Debt-Service Coverage	4.93	4.58	5.29	11.00
BPA Aggregate Debt-Service Coverage	1.26	1.06	1.08	1.20
Total BPA Debt/Funds Available for Debt Service	8.0	10.2	10.5	10.4
Liquidity				
Days Cash On Hand	204	130	133	82
Days Liquidity On Hand	235	130	133	82
Leverage				
Equity/Capitalization (%)	13	9	6	2
Selected Balance-Sheet Items				
Total Operating Revenues	3,419,369	3,268,083	3,197,911	3,612,104
Total Operating Expenses	2,209,136	2,212,389	2,160,170	2,591,555
Operating Income	1,210,233	1,055,694	1,037,741	1,020,549
Funds Available for Debt Service	1,663,562	1,336,698	1,314,528	1,315,309
Total Annual Debt Service (ENW)	337,627	291,540	248,475	119,534
Total Annual Debt Service (BPA)	1,321,594	1,263,560	1,215,976	1,095,216
Total Cash	1,225,075	651,740	654,242	503,026
Total Debt	13,320,787	13,612,450	13,798,089	13,665,307
Equity	1,945,357	1,334,294	847,424	343,748

BPA – Bonneville Power Administration. ENW – Energy Northwest. Source: Company reports.