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Tagging Info

Fitch Rates Energy Northwest, WA's Columbia Generating Station 'AA' & Bonneville Power Implied 'AA' Ratings

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Fitch Ratings-San Francisco-09 December 2010: Fitch Ratings has assigned an 'AA' rating to Energy Northwest, WA's $155 million Columbia Generating Station electric revenue refunding bonds, series 2010-D. In addition, Fitch has assigned an 'AA' implied non-federal revenue bond rating to Bonneville Power Administration (BPA).

Proceeds from the 2010-D bonds will fund improvements at the Columbia Generating Station. The bonds are expected to price in a negotiated sale Dec. 14, 2010. The bonds do not have a debt service reserve fund.

Fitch also affirms the following outstanding Energy Northwest ratings:

--$1.7 billion Project 1 revenue bonds at 'AA';
--$2.3 billion Columbia Generating Station revenue bonds at 'AA';
--$1.6 billion Project 3 revenue bonds at 'AA'.

The Rating Outlook is revised to Stable from Positive. The Outlook revision reflects constraints on financial performance, particularly in reserve levels, that could continue in the next few years.

SECURITY
The Energy Northwest bonds are secured by a payment obligation from BPA. BPA's payments to Energy Northwest are made as an operating expense and are paid prior to BPA's payments to the U.S. Treasury (approximately $6.5 billion in Treasury obligations outstanding.

RATING RATIONALE:
--BPA's credit strength is supported by its regional position as the leading provider of electricity and transmission in the Pacific Northwest, with a competitive resource portfolio that provides wholesale electricity (primarily low cost hydropower) and transmission to a population of more than 12 million people through its 135 public utility customers.
--The value of BPA's power supply is demonstrated by the signing of new cost-based contracts with all preference customers that now extend from 2012 to 2028 and reduce the price risk to BPA.
BPA has a two-year rate-setting cycle with mid-period cost adjustments allowed. Additionally, regulatory oversight by the Federal Energy Regulatory Commission (FERC) is designed to ensure rates are sufficient to recover BPA's total costs.
--BPA's financial performance fluctuates as a result of hydrological conditions and market prices, given its reliance on secondary (surplus) sales for approximately 22% of total revenues. BPA proposes reducing this in the next rate case to 14%, which may help reduce revenue variability.
--Financial results improved since the western energy crisis but have declined in the past two years due to considerably lower than projected surplus power sales.
--Recent increases from the federal government in BPA borrowing capacity for both long-term and short-term needs should provide adequate debt capacity for BPA to fund its capital improvement plan.

KEY RATING DRIVERS
--Recovery of hydrological conditions to average levels, consistent with BPA's assumption used in financial forecasting and rate setting, will be key to improved financial performance.
--Bonneville's successful completion of its rate case for fiscal 2012-2013 should increase revenues to fund reinvestment in system assets and reduce reliance on secondary revenues from the wholesale market.

BPA continues to face financial pressure related to lower than average hydrological conditions with sustained low electricity market prices for its secondary sales being driven by overall weakened economic conditions. BPA's rate setting takes into account anticipated secondary sales. Secondary sales revenues are derived from the portion of the federal system not allocated under slice contracts. Cost-based rates for wholesale customers are established using extensive modeling of potential hydrological conditions but assume some level of secondary revenues based on average water conditions and forecasted market prices. In a low water year, these revenues may likely be lower than projected, requiring the use of cash reserves to replace lost revenues and, eventually, a rate adjustment to customers.

As indicated in Fitch's last review, financial performance in fiscal 2010 was expected to be much lower than budget due to a continuation of the historically rare combination of very dry water conditions and depressed wholesale electricity prices. Although performance slightly exceeded the loss anticipated during Fitch's February 2010 review, revenues still fell well below budgeted revenues and produced negative operating cash flow that resulted in a further spend down in cash reserves. Total coverage of all obligations, including the repayment of federal debt, was below 1.0 times (x) at 0.7x, based solely on cashflow from operations. BPA utilized unencumbered cash reserves to cover cost of full obligations. For the power supply business, in particular, unrestricted cash declined to $233 million from $516 million. Such cash reserves are projected to potentially drop to only $93 million in fiscal 2011 and may stay in this range through the next rate case period (fiscal 2012-fiscal 2013).

The need for additional liquidity in the form of short-term borrowing will be driven by hydrological conditions and market prices that will determine how close secondary revenues are to forecasted levels. Secondary revenues are forecasted to provide approximately 14% of revenues in fiscal 2012, which favorably represents a decline from historical reliance on secondary revenues of approximately 22% of budgeted revenues. BPA has short-term borrowing options available to supplement its low reserves levels in the form of reserves that can be borrowed from the transmission business (unencumbered reserves of $606 million at the end of fiscal 2010) and a line of credit in the amount of up to $750 million available from the federal government.

BPA is now in the practice of establishing rates for two-year periods, which is substantially shorter than its previous three and five-year rate periods. BPA has proposed rates for the period Oct. 1, 2011 - Sept. 30, 2013 (Fiscal 2012-Fiscal 2013). A formal rate process will follow and the final proposal is expected to be sent to FERC for its approval in July 2011. BPA's initial proposal is a base rate increase of 8.5%. Much of the increase would fund planned capital investments in the existing hydro-generation system and a portion of the proposed rate increase would compensate for BPA's plan to lower its forecasted secondary revenues in the rate period by approximately 8%. The proposed rate case does not contemplate substantial improvement in power system reserve levels, unless performance exceeds the forecast.

BPA is the largest of the regional federal power marketing agencies within the Department of Energy (DOE). BPA was created by Congress in 1937 to market electric power from the Bonneville Dam. Congress has since designated BPA to market power from 31 federally owned hydro projects in the Pacific Northwest. BPA accounts for approximately 33% of the electricity consumed and 75% of the transmission infrastructure in the region. BPA's overall portfolio of resources from which it markets power is approximately 8,478 MW, as estimated under low water conditions.
For additional information on Energy Northwest and Bonneville Power Administration see Fitch Report 'Energy Northwest; Bonneville Power Administration' dated March 15, 2010.

Considerations for Taxable Investors
The following sector credit profile is provided as background for investors new to the municipal market.

Public Power Bonds - Key Credit Points:
Public power utility bonds in most cases are unsecured debt obligations supported solely by a pledge of net revenues generated by the utility including other legal structural protections, such as rate covenants, and debt service reserve fund requirements. Public power utilities (municipal and cooperative) are effectively owned by their customers with a mission to provide essential, reliable, relatively low cost electric service. The average rating is 'A+', compared to their corporate counterparts' average rating of 'BBB+', with approximately 40% rated at or above 'AA-' and 8.6% rated at or below 'BBB+'. The key credit underpinning supporting the high average rating is their self regulating authority (or local rate setting ability). Municipal utilities are generally not subject to state/federal regulatory oversight as compared to corporate utilities. This regulatory autonomy provides for a more timely recovery of costs (operating and debt service) through electric rates, and also gives public power issuers the ability to set financial targets/policies as well as renewable energy goals/standards. In addition, public powers predominantly residential customer composition provides for more stable energy sales and in turn more predictable financial performance. Those with below average ratings or low investment-grade or below-investment-grade ratings generally have a limited economic base, above average leverage (or debt burden) resulting in a high cost structure that may constrain financial flexibility.

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Additional information is available at 'www.fitchratings.com'.

Applicable Criteria and Related Research:
'Revenue-Supported Rating Criteria', dated Oct. 8, 2010;
'Public Power Rating Guidelines', dated June 11, 2009.

For information on Build America Bonds, visit 'www.fitchratings.com/BABs'.

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Revenue-Supported Rating Criteria
Public Power Rating Guidelines

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