

Research

Bonneville Power Administration, Oregon; Retail Electric; Wholesale Electric

08-Apr-2010

Current Ratings

Credit Profile

Conservation and Renewable Energy Sys, Washington

Bonneville Pwr Admin, Oregon

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

Long Term Rating	AA/Stable	Affirmed
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Energy Northwest, Washington

Bonneville Pwr Admin, Oregon

Energy Northwest (Bonneville Pwr Admin) (1,Columbia,3)

Long Term Rating	AA/Stable	Affirmed
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+ Bonneville Pwr Admin elec rev rfdg bnds

Unenhanced Rating	AA(SPUR)/Stable	Affirmed
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+ Energy Northwest (Bonneville Pwr Admin)

Unenhanced Rating	AA(SPUR)/Stable	Affirmed
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Rationale

Standard & Poor's Ratings Services has affirmed its 'AA' long-term and underlying ratings on several nonfederal debt obligations that the **Bonneville Power Administration**, Ore. (BPA) pays as operating expenses of its electric system. The outlook is stable.

The BPA nonfederal obligations include:

- \$5.9 billion of **Energy Northwest** (ENW), Wash.'s revenue and refunding bonds;
- \$127.8 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;
- \$23.8 million of **Northern Wasco Public Utility District**, Ore. (McNary Dam Project) bonds;
- \$16.1 million of **Conservation and Renewable Energy System** bonds; and
- \$9.6 million of **Tacoma**, Wash., Conservation System Project bonds.

The 'AA' ratings on BPA and its nonfederal debt reflect the application of our government related entities criteria (GRE) to BPA. It is based on our opinion that BPA's stand-alone credit profile is 'AA-', and our view that there is a "high" likelihood that the U.S. federal government (AAA/Stable/A-1+) would provide extraordinary support to BPA in financial distress.

Applying our GRE criteria, we believe there is a "high" likelihood of "extraordinary" government support for BPA obligations based on the "strong" link between the BPA and the federal government as well as the "important" role the BPA plays in the overall Pacific Northwest.

The GRE rating reflects our view of:

- BPA'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 during financial distress; and
- The utility's important contributions to the Pacific Northwest's economy, where it indirectly serves about 12 million electric customers in seven states, provides low-cost power that is critical to the region's economic health, and operates key transmission resources.

BPA'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' \$3.25 billion (or 73%) increase in the agency's federal borrowing authority in 2009;
- The legislative mechanism that allows BPA to defer repaying federal obligations if it lacks the financial resources to meet all of its operating and debt obligations;
- A track record of strong coverage of nonfederal debt service;
- The utility's exceptionally broad and diverse service territory;
- The strong, efficient, and economical operations of the federal Columbia River Power System (FCRPS) hydroelectric power system fosters strong demand for the output of the combined FCRPS hydroelectric projects and ENW nuclear production;
- Robust liquidity that tempers the impact of variable hydrology conditions on financial performance and mitigates credit risks inherent in biennial rate cases;
- BPA's lengthy record of financial capacity to meet its federal and nonfederal obligations; and
- New 20-year contracts between BPA and its customers, demonstrate the customer base's commitment to the utility's system.

Although we believe debt service coverage of federal and nonfederal obligations was only adequate in 2009 because poor hydrology conditions and low wholesale electric prices eroded surplus power sales revenues and financial performance, we also believe robust liquidity provided a cushion that tempered the financial implications of these pressures.

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

- Financial performance hinges on hydrology conditions that can impair surplus power sales revenues and require replacement power purchases that add to expenses. This happened in 2009, and BPA projects will recur to a greater extent in 2010.
- Highly politicized and protracted biennial rate proceedings can delay rate relief and constrain the benefits of autonomous ratemaking authority and financial flexibility.
- BPA's new customer contracts do not establish rates and it will need to rely on future rate proceedings.
- We believe the utility is exposed to volatile wholesale power markets because customer needs exceed FCRPS and ENW's output, which leads to market power purchases.
- Weak market power prices, like those of 2009, could compromise revenues from surplus energy sales.
- BPA is projecting \$4 billion-\$5 billion of capital needs through 2014, beyond ENW's capital needs, which will add to both organizations' debt.

BPA markets electricity generated at 31 federal hydroelectric projects; ENW's nonfederal, nuclear Columbia Generating

Station; and several nonfederal small power plants. It also operates an extensive transmission system that facilitates power marketing activities accounting for about one quarter of 2009's operating revenues. Its transmission system represents about 75% of the Pacific Northwest's transmission capacity.

BPA treats debt service on its \$6.6 billion of nonfederal debt as an operating expense. It pays nonfederal debt ahead of debt service on \$6.5 billion of federal debt. Federal debt includes bonds issued to the U.S. Treasury and federal appropriations that the administration must repay with interest. The nearly 1-to-1 ratio of nonfederal-to-federal debt facilitates debt service coverage of at least 2x for the nonfederal bonds so long as rates meet all financial obligations, including the federal debt.

BPA can defer its federal debt payments if after paying operating expenses, which include nonfederal debt service, it cannot meet its total obligations. However, in the first instance, the utility is legally required to establish rates that it projects will cover all operating expenses, and federal and nonfederal obligations. Moreover, interest accrues on federal debt repayments that BPA defers.

In the event of financial shortfalls that exceed defined thresholds, the utility has a cost recovery rate adjustment mechanism available to make limited rate adjustments without initiating protracted rate proceedings. BPA revisits base rates every two years.

About 80% of the power the utility sells is hydroelectric. Its hydroelectric resources' performance hinges on hydrology conditions. Hydrology conditions were 18% below the 30-year historical average in 2009 and BPA projects conditions 26% below the average in 2010.

The agency has also committed to pay for the output of ENW's single operating nuclear plant and support the debt of two other nuclear plants that are unfinished or dormant. Nuclear electricity production accounts for 9%-12% of electricity sales. The lower end of this range reflects years with refueling outages. The Columbia Generating Station nuclear plant had five unplanned shutdowns in 2009. We view that year's repeated outages as creating the potential for higher costs at a utility that only revisits base rates every two years. Nevertheless, BPA's unconditional obligation to service ENW's debt mitigates some of our concerns.

Because only one nuclear plant, the Columbia Generating Station, also supports the debt of nonoperating nuclear plants, the resulting debt per kilowatt (kW) for the Columbia Generating Station's 1,157 megawatt (MW) capacity is very high, in our view, at nearly \$5,700 per kW. The debt burden would be lower but for the BPA-initiated debt optimization program. This program reduced the agency's overall debt obligations by accelerating some federal debt while deferring ENW debt for payment in later periods.

The combination of low-cost FCRPS hydroelectric production and the nuclear plant's generally sound operations let BPA maintain very competitive wholesale rates for its customers. The current rate for preference customers is 2.8 cents per kilowatt-hour for FCRPS and ENW power. BPA implemented this level of rates in October 2009 and projects these rates will remain in effect through September 2011, even though it faces poor hydrology conditions.

We believe accrual coverage of nonfederal debt service was very strong in 2005-2008, equaling at least 4.3x. In 2009, coverage of nonfederal debt was markedly weaker, but nevertheless strong at 2x. Nonfederal debt service coverage in 2009 reflected poor hydrology conditions. Furthermore, weak natural gas prices eroded wholesale market prices for the surplus electricity available for sale.

Accrual combined federal and nonfederal debt service coverage fell to what we consider merely adequate 1.0x in 2009 from 1.1x in 2008, and 1.2x in 2007. Cash debt service coverage in 2009 was 0.8x, which was accompanied by a nearly \$360 million draw on unrestricted cash and investments in fiscal 2009. BPA projects another weak hydrology year for

2010, which we believe could further erode coverage and lead to additional draws on cash reserves. Unrestricted cash and investments of \$1.37 billion at fiscal year-end 2009 represented more than six months' operating expenses, which we view as robust and provides a cushion for responding to the weak hydrology conditions.

In February 2009, the federal stimulus package raised BPA's debt ceiling by \$3.25 billion to \$7.70 billion. As the utility adds more federal debt and nonfederal debt amortizes, the budgetary directive that it cover all of its debt and expense obligations should translate into stronger coverage of nonfederal obligations.

Outlook

The stable outlook reflects our view of the cushion that the Treasury debt provides to the ENW and other nonfederal debt and a lengthy track record of timely Treasury payments. The outlook also reflects our assessment of the availability of the cost recovery adjustment clause and strong liquidity as buffers against BPA's exposure to hydrology conditions and wholesale power markets. Exposure to hydrology conditions and wholesale markets constrains upside rating potential and could potentially erode credit quality.

Strong Liquidity

BPA's liquidity benefits from its customers' migration to a direct pay system that modifies the historical net billing arrangement. Under the net billing arrangement, customers remitted funds to ENW, rather than to BPA. ENW paid BPA only after it had fully funded its annual debt service and operations and maintenance (O&M) obligations. This typically took about four months. Under the direct-pay arrangement, customers pay BPA directly and it makes monthly payments to ENW to cover its debt service and O&M, leaving BPA with stronger liquidity. Direct payments to the utility enhanced liquidity.

BPA had unrestricted cash of nearly \$1.4 billion at fiscal year-end 2009, down from \$1.7 billion at fiscal year-end 2008. Even with the decline, liquidity represented what we consider a strong 57% of annual operating expenses in 2009, compared with 79% of annual operating expenses in 2008. Weak hydrology conditions and soft market prices for wholesale electric sales of surplus power contributed to 2009's demands on liquidity.

BPA can defer federal debt maturities in the event of spikes in operating costs and liquidity pressures. The last deferral was in 1983.

Limited Rate Oversight

BPA develops its rate proposals as part of biennial rate proceedings. It implements the rate proposals after the Federal Energy Regulatory Commission confirms compliance with federal statutory requirements, such as sufficiency to meet all financial obligations. The biennial rate-setting process solicits input from regional stakeholders, which translates into a lengthy and typically politically charged process. Stakeholders include customers, environmental agencies, and other interested parties. The revised rates the utility implemented in October 2009 are to remain in effect through September 2011.

A cost recovery adjustment clause that took effect Oct. 1, 2006, enabled BPA to increase rates by up to \$300 million, or about 10%, each year, to account for wholesale revenue shortfalls. In 2010, the utility raised the trigger from a \$300 million deficit to about \$700 million to reflect the benefits of the \$750 million U.S. Treasury credit line that it can use to cover shortfalls. The adjustment mechanism's formulaic nature mitigates the risks of the lengthy review process. However, the higher trigger and BPA's decision to address the 2009-2010 hydrology conditions in its next biennial rate proceeding introduce regulatory lag that dilutes its financial flexibility.

Customers accepted a contract that will go into effect in 2011. BPA expects that the contract will help it to better manage its supply obligations and financial exposures to market costs for wholesale power. BPA customers will pay tiered rates after current contracts expire in 2011. Although proceedings will set the precise rates, the utility and its customers have

agreed on a rate structure in which a first tier would reflect the cost of FRCPS and ENW energy and limited supplemental market power, and a second tier would have customers paying market prices for energy beyond these capabilities. The tiered structure focuses on providing equitable cost allocation among customers by requiring BPA's fastest-growing customers to shoulder the utility's costs of securing additional energy and capacity resources to meet these customers' needs. This rate structure should shield slower growth customers from socialized costs. It should be revenue neutral to BPA. A number of customers have commenced legal proceedings challenging the revised rate structure.

BPA is legislatively mandated to share benefits of its low-cost power with regional investor-owned utilities' residential and small-farm customers. The extent of cost- and benefit-sharing between preference customers and investor-owned utility customers is the subject of lengthy litigation. The outcome of these disputes should be revenue neutral for BPA, because its rates must cover all costs irrespective of allocation among different groups. Nevertheless, the legal wrangling is a credit concern, because it places meaningful demands on management.

Markets: Large And Diverse Customer Base

BPA's wholesale customers include public utilities, public utility districts, municipal districts, cooperative utilities, and investor-owned utilities. Surplus energy is first offered to customers, then to other utilities in the West. Surplus sales' margins offset operating costs.

The large customer base includes 61 cooperative utilities, 17 federal agencies, 14 investor-owned utilities, 48 power marketers, 53 municipalities, and 30 public utility districts, among others. We believe favorable project economics create strong demand for FCRPS and ENW generation, which contributes to a secure revenue stream and credit quality. In fiscal 2009, customers entered 20-year contracts that will replace 10-year contracts expiring in 2011.

Large Operational Diversity

The FCRPS hydroelectric capacity exceeds 21,000 MW and is spread over 206 generating units, which provides for what we consider tremendous operational diversity. However, the hydroelectric system's sustained peak capacity is a meaningfully lower 12,700 MW. These resources are exposed to hydrological conditions that can impair operational and financial performance by reducing hydroelectric output. Fish migration needs and flood control can also constrain hydroelectric production.

ENW's Columbia station provides 1,157 MW of nuclear capacity and exhibits strong availability and capacity factors between refueling cycles. Nuclear electricity production accounts for 9%-12% of electricity sales. The lower end of this range reflects years with refueling outages, which happen every other year.

ENW's \$5.9 billion of debt is associated with only 1,157 MW of operating nuclear capacity. By comparison, 21,000 MW of hydroelectric capacity bears \$6.5 billion of federal debt. Therefore, the debt service costs per megawatt-hour of nuclear production are about 7x-8x the cost of hydroelectric production. The debt burden would be lower but for the BPA-initiated debt optimization program. This program reduced the administration's overall debt obligations by accelerating federal debt while deferring ENW debt payments.

Related Criteria And Research

- [General Criteria: Enhanced Methodology And Assumptions For Rating Government-Related Entities](#), June 29, 2009
- USPF Criteria: [Electric Utility Ratings](#), June 15, 2007

Ratings Detail (As Of 08-Apr-2010)

Energy Northwest, Washington

Bonneville Pwr Admin, Oregon

Energy Northwest elec rev rfdg bnds ser 2005 A & taxable ser B dtd 05/26/2005 due 07/01/2008 2013-2018

<i>Long Term Rating</i>	AA/Stable	Affirmed
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Energy Northwest elec rev rfdg bnds (1,columbia,3) ser 2004AB&C dtd 06/02/2004 due 07/01/2007-2018

<i>Unenhanced Rating</i>	AA(SPUR)/Stable	Affirmed
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Energy Northwest proj 1, Columbia Generating Sta, & proj 3 elec rfdg

<i>Long Term Rating</i>	AA/Stable	Affirmed
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Energy Northwest proj 1, Columbia Generating St, & proj 3 elec rev rfdg bnds (Bonneville Pwr Admin) ser 2006 A-D

<i>Long Term Rating</i>	AA/Stable	Affirmed
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Energy Northwest (Bonneville Pwr Admin) proj 3 elec rev rfdg bnds var rate ser F-1 ser 2008-F

<i>Long Term Rating</i>	AA/A-1/Stable	Affirmed
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Energy Northwest (Bonneville Pwr Admin) proj 3 elec rev rfdg bnds var rate ser F-2 ser 2008-F

<i>Long Term Rating</i>	AA/A-1/Stable	Affirmed
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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
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Energy Northwest (Bonneville Pwr Admin) proj 3 elec rev rfdg bnds var rate subser F-2 (Bonneville Pwr Admin) ser 2008-F dtd 06/17/2008 due 07/01/2018

<i>Long Term Rating</i>	AA/Stable	Affirmed
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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
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Energy Northwest (Bonneville Pwr Admin) rfdg rev bnds (Nuclear Proj #2) ser 1993A dtd 05/01/93 due 07/01/1994-1998 2000-2002 2004-2007 2009-2010 2012

<i>Unenhanced Rating</i>	AA(SPUR)/Stable	Affirmed
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Energy Northwest (Bonneville Pwr Admin) Sub Lien

<i>Long Term Rating</i>	AA/Stable	Affirmed
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Energy Northwest (Bonneville Pwr Admin) (MBIA) (AGM)

<i>Unenhanced Rating</i>	AA(SPUR)/Stable	Affirmed
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Energy Northwest (Bonneville Pwr Admin) (Nuclear Proj 1,2,3)

<i>Long Term Rating</i>	AA/Stable	Affirmed
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+ Bonneville Pwr Admin elec rev rfdg bnds ser 2005 A & taxable ser B dtd 05/26/2005 due 07/01/2008 2013-2018

<i>Unenhanced Rating</i>	AA(SPUR)/Stable	Affirmed
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+ Bonneville Pwr Admin elec rev rfdg (Colu)

<i>Unenhanced Rating</i>	AA(SPUR)/Stable	Affirmed
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+ Energy Northwest rfdg elec rev bnds (Bonneville Pwr Admin)

<i>Unenhanced Rating</i>	AA(SPUR)/Stable	Affirmed
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+ Energy Northwest (Bonneville Pwr Admin)

<i>Unenhanced Rating</i>	AA(SPUR)/Stable	Affirmed
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+ Energy Northwest (Bonneville Pwr Admin) (XL Capital Assurance Inc.)

<i>Unenhanced Rating</i>	AA(SPUR)/Stable	Affirmed
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+ Washington Pub Pwr Supp Sys (Bonneville Pwr Admin) (Nuclear Proj 1-3) rfdg rev bnds ser 1997A dtd 09/01/1997 due 07/01/2008-2017

<i>Unenhanced Rating</i>	AA(SPUR)/Stable	Affirmed
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+ 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
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+ Washington Pub Pwr Supp Sys (Nuclear Proj #3) (Bonneville Pwr Admin)

Unenhanced Rating AA(SPUR)/Stable Affirmed

Lewis Cnty Pub Util Dist #1, Washington

Bonneville Pwr Admin, Oregon

Lewis Cnty Pub Util Dist #1 (Bonneville Pwr Admin) (Cowlitz Falls Hydroelec Proj) ser 1991 1993 2003

Long Term Rating AA/Stable Affirmed

+ Lewis Cnty rev rfdg bnds (Bonneville Pwr Admin) (Cowlitz Falls Hydroelectric Proj) ser 2003 dtd 07/16/2003 due 10/01/2007-2012

Unenhanced Rating AA(SPUR)/Stable Affirmed

+ Lewis Cnty (Bonneville Pwr Admin) rev rfdg bnds (Cowlitz Falls Hydroelectric Proj) ser 2003 dtd 07/16/2003 due 10/01/2013-2024

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) (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

Tacoma, Washington

Bonneville Pwr Admin, Oregon

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

Long Term Rating AA/Stable Affirmed

Many issues are enhanced by bond insurance.

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