FitchRatings

FITCH RATES ENERGY NORTHWEST, WA'S ELECTRIC REVENUE & REFUNDING BONDS 'AA'; OUTLOOK STABLE

Fitch Ratings-San Francisco-31 May 2011: Fitch Ratings has assigned 'AA' ratings to the following bonds issued by Energy Northwest (ENW) and secured by payments from the Bonneville Power Administration (BPA):

--$4.5 million Columbia Generating Station electric revenue and refunding bonds, series 2011-C (taxable);
--$156,44 Project 1 electric revenue refunding bonds, series 2012-A;
--$445 million Columbia Generating Station electric revenue refunding bonds, series 2012-A;
--$68.29 million Project 3 electric revenue refunding bonds, series 2012-A.

The par amounts are subject to market conditions. These bonds are expected to price the week of June 6, 2011, but are being offered on a forward basis and will not be delivered until April 2012. Proceeds from the series 2012 bonds will restructure debt for financial relief in the fiscal 2012-2013 rate period. The result is to delay upcoming debt service payments out to later years in order to provide the BPA with some budgetary relief in the next few years. The bonds do not have a debt service reserve fund.

Fitch also affirms the following outstanding ratings on debt issued by Energy Northwest and secured by payments from the Bonneville Power Administration:

--$1.74 billion Project 1 revenue bonds at 'AA';
--$2.48 billion Columbia Generating Station revenue bonds at 'AA';
--$1.62 billion Project 3 revenue bonds at 'AA';
Fitch also affirms its implied non-federal revenue bond rating on Bonneville Power Administration at 'AA'.

The Rating Outlook is Stable.

SECURITY
The ENW bonds are secured by a payment obligation from the BPA. BPA's payments to ENW 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 a competitive resource portfolio that provides wholesale electricity (primarily low-cost hydropower) and transmission access to a population of more than 12 million people through its 135 public utility customers, making it the leading provider of electricity and transmission in the Pacific Northwest.
--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 reliance 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 (fiscals 2010 and 2009) 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 help 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. Fitch anticipates that hydrological variability will be an ongoing credit characteristic that drives Bonneville's financial performance.

Financial performance in fiscal 2010 was low due to a continuation of the historically rare combination of very dry water conditions and depressed wholesale electricity prices. Revenues 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. Unencumbered cash reserves for the power supply business declined to $233 million from $516 million.

Performance to date in fiscal 2011 is slightly improved. Revenues are higher than fiscal 2010 due to higher streamflows which has led to higher secondary energy sales even though wholesale market prices have remained low. However, the power supply reserves are projected to still decline, although not as drastically as was anticipated by the fiscal 2011 budget. Power supply reserves for risk are now projected to be around $211 million. Reserves 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. Bonneville has liquidity flexibility in the form of very strong reserves in the transmission business line (estimated at $579 million at year end fiscal 2011). The power system can borrow with interest in the short-term from the transmission business line. BPA also has access to borrowing up to $750 million for up to one year in a federal line of credit.

BPA is now in the practice of establishing rates for two-year periods, which is substantially shorter than its previous six year rate periods. BPA has proposed rates for the period Oct. 1, 2011 - Sept. 30, 2013 (Fiscal 2012-Fiscal 2013). A formal rate process is in progress and the final proposal is expected to be sent to FERC for its approval in July 2011. BPA's proposal is a base rate increase of 8.5%. Much of the increase would fund investments in the existing generation system and a portion of the proposed increase is to compensate for BPA's plan to lower its forecasted secondary revenues in the rate period by approximately $45 million, or 8% according to the initial rate proposal. The proposed rate case does not contemplate substantial improvement in power system reserve levels, unless performance exceeds the forecast. The two-year rate case does not prevent BPA from adjusting rates in the interim period. The principal mechanism for rate adjustments during the rate period is the cost recovery adjustment clause (CRAC). The adjustment triggers automatically based on a variety of factors that includes forecasted year end net revenues or to recovery any borrowing that may be done from Treasury for liquidity purposes.

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 megawatts (MW), as estimated under low water conditions.

For additional information on Energy Northwest and Bonneville Power Administration see the Fitch report 'Energy Northwest; Bonneville Power Administration' dated March 15, 2010.

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In addition to the sources of information identified in Fitch's Revenue-Supported Rating Criteria, this action was additionally informed by information from Creditscope.

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

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

Applicable Criteria and Related Research:
Revenue-Supported Rating Criteria
http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=564565
U.S. Public Power Rating Criteria
http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=613065