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Rating Update: MOODY'S DOWNGRADES BONNEVILLE POWER ADMINISTRATION AND RELATED RATINGS TO Aa1. THE RATING OUTLOOK IS STABLE.

Global Credit Research - 31 Aug 2011

Approximately $6.3 billion of debt affected

Electric Utilities
WA

Opinion

NEW YORK, Aug 31, 2011 -- Moody's has downgraded Bonneville Power Administration (BPA) issuer and related ratings to Aa1 from Aaa. BPA related ratings include Energy Northwest Project 1, Energy Northwest Project 3, Energy Northwest Columbia Generating Station, Conservation and Renewable Energy System Conservation Project, Cowlitz Falls Hydroelectric Project, McNary Dam Fishway HydroElectric, Northwest Infrastructure Financing Corp Transmission Facilities Lease, and Conservation System Project Revenue Bonds. The outlook is stable.

The rating action reflects significant hydrology and market price risk in BPA's power services business that has led to credit quality deterioration over the last several years. Driven by low regional hydrology, low wholesale market prices and rising non-federal debt service, total reserves available for risk dropped a cumulative 36% over a two year period ending in FY 2010 while non-federal debt service coverage dropped to around 1.8-1.9 times in 2009 and 2010 compared to 4.4 times average from 2004 to 2008. In Moody's view, challenging wholesale market conditions are expected to continue over the next several years given low natural gas prices, sustained lower demand and increasing amounts of wind generation during BPA's peak surplus energy sales season. That said, BPA's financial performance achieved relative stability in FY 2011 due to extraordinary high water flows estimated at 133% of average water. For fiscal year-end September 2011, total reserves for risk are expected to decline by $35 million compared to the $253 million reduction in FY 2010 and $200 million reduction in FY 2009. Total reserves for risk at FY 2010 were around $815 million.

The downgrade also reflects BPA's finalized FY 2012-2013 rate plan that incorporates modest expected decline in BPA's total reserves available for risk at around $747 million by FY 2013 while non-federal debt service coverage ratios are expected to modestly improve to around 2 times compared to 1.8 times (Moody's calculation) in FY 2010. Total debt service coverage is also expected to improve to around 1.0 times compared to around 0.8 times in FY 2009 and 2010. Strong liquidity remains an important risk mitigation tool since the FY 2012-2013 rate case incorporates substantial gross secondary revenue averaging around $615 million (net around $415 million) per year though the amount is on average $75 million less per year than the FY 2010-2011 rate case.

Moody's notes that BPA's final rate decision incorporates a 7.8% average rate increase, which is lower than the 8.5% proposed. The lower rate increase reflects various lower costs incorporated in the final FY2012-2013 rate period including lower debt costs achieved by Energy Northwest's bond refundings in 2011. Moody's also recognizes that the cost recovery adjustment clause (CRAC) mechanism and the NFB surcharge mechanism are substantially similar to the FY 2010-2011 rate case.

That said, BPA's Aa1 ratings are supported by U.S. government support features including a $7.7 billion borrowing authority with the US Treasury and the legal ability to defer its annual Treasury repayment (if necessary), BPA's importance to the US Northwest region, strong underlying hydro and transmission assets, and 18-year power supply contracts with creditworthy public power entities for a large majority of power sales.

The stable outlook reflects BPA's expected financial performance and reserves available for risk in FY 2012-2013 according to its final rate case.

BPA's rating could improve over the long term if BPA is able to fully mitigate hydrology and wholesale price risk, if BPA implements policies to ensure strong reserve levels, if BPA sustains financial performance stronger than expected and if the US Government's rating stabilizes at Aaa. Additionally, BPA's related ratings could be upgraded if BPA is upgraded.

BPA's rating could be lowered if BPA's coverage ratios or reserves available for risk materially drops below expected, if US government support features are diminished, if there are federal constraints placed on BPA or if the US government ratings are lowered below Aa1. Additionally, BPA's related ratings could be downgraded if BPA is downgraded or if the underlying contracts (such as the net billing agreements) are violated.

Background on BPA

In 1937, an act of Congress created BPA to market power from hydroelectric facilities constructed on the Columbia River. The Army Corps of Engineers and the Bureau of Reclamation operate the hydro projects. BPA is one of four regional power marketing agencies within the Department of Energy. Many of the statutory authorities of BPA are vested with the Secretary of Energy, who appoints and acts through the BPA administrator. BPA's wholesale power rates are approved by the Federal Energy Regulatory Commission to ensure full-cost recovery. Federal law requires BPA to meet specified energy requirements in the Northwest region.

Credit Fundamentals

Strengths

* BPA benefits from U.S. government support including $7.7 billion in direct borrowing authority with the US Treasury ($2.51 billion drawn as of FY 2010) and the legal ability to defer its annual Treasury repayment if necessary to meet non-Federal debt service commitments (which includes BPA related debt) under the net billing agreements. BPA has established the planning policy of meeting a 95% probability over the next two years of making its U.S. Treasury payment on time which is a key strategy to ensure timely revenue bond debt service payment

* BPA's extensive hydroelectric system strongly anchors its firm competitive wholesale rate position relative to market based prices over the

long term

* BPA's important role in the northwest region of the U.S. since BPA owns and operates roughly 75% of the bulk transmission system and markets competitive hydroelectric power amounting to roughly 35% of the region's power

* BPA sells a majority of its power under 18-year power supply contracts with creditworthy public power entities and derives roughly 25% of revenues from stable transmission revenues

Challenges

* Significant exposure to hydrology risk and wholesale power markets contributes to cash flow volatility

* Extensive ratemaking process creates potential complications in timely rate recovery

* Conflicting uses of Columbia River, (flood control, irrigation, navigation, recreation, municipal and industrial water supply, fish and wildlife protection and power generation), can hinder the ability of the system to manage load from the federal system and contribute to substantial additional costs

* Development of wind energy has presented complicated transmission/load balancing issues and contributes to lower market prices

* Large debt funded capital program totaling $2.3 billion for FY 2012-2013

* Decline in BPA's historically strong liquidity and financial metrics in FY 2009 and 2010 though financial metrics and reserves are expected to stabilize in FY 2012-2013

Outlook

The stable outlook reflects BPA's expected financial performance and reserves available for risk in FY 2012-2013 according to its final rate case.

What could move the rating - DOWN

BPA's rating could be lowered if BPA's coverage ratios or reserves available for risk materially drops below expected, if US government support features are diminished, if there are federal constraints placed on BPA or if the US government ratings are lowered below Aa1. Additionally, BPA's related ratings could be downgraded if BPA is downgraded or if the underlying contracts (such as the net billing agreements) are violated.

What could move the rating - UP

BPA's rating could improve over the long term if BPA is able to fully mitigate hydrology and wholesale price risk, if BPA implements policies to ensure strong reserve levels, if BPA sustains financial performance stronger than expected and if the US Government's rating stabilizes at Aaa. Additionally, BPA's related ratings could be upgraded if BPA is upgraded.

KEY STATISTICS:

Aggregate BPA Power Capacity, 2011 Operating Year at median water conditions: 10,755 average megawatts

Non-Federal Debt Service Coverage Ratio, 2010 (reported): 2.2 times

Available BPA Reserves, 2010 (encumbered and unencumbered): $ 1.11 billion

Total Reserves Available for Risk, 2010: $815 million

BPA Payment to U.S. Treasury, 2010: $867 million

Authorized Line of Credit With U.S. Treasury, 2010: $7.7 billion ($2.51 billion drawn)

BPA Full-Requirement Power Rate, 2010: $29/MWh

Columbia Generating Station Nameplate Capacity: 1,130 MW

Non-federal debt, FY 2010: $6.3 billion

Federal debt, FY 2010: $6.8 billion

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The principal methodology used in this rating was U.S. Public Power Electric Utilities published in April 2008. Please see the Credit Policy page on www.moodys.com for a copy of this methodology .

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