FitchRatings

Tagging Info

Fitch Rates Energy Northwest (WA) Electric Rev Bonds 'AA'

Ratings Endorsement Policy

01 Aug 2012 10:32 AM (EDT)

Fitch Ratings-San Francisco-01 August 2012: Fitch Ratings assigns an 'AA' rating to the following bonds issued by Energy Northwest, WA (EN) and secured by payments from the Bonneville Power Administration (BPA):

--Approximately $34.6 million Columbia Generating Station (CGS) electric revenue bonds, series 2012D;
--Approximately $740.9 million Columbia Generating Station electric revenue bonds, series 2012E (taxable).

The bonds are expected to price the week of Aug. 13, 2012. Proceeds will fund approximately $40 million to finance repairs and improvements at CGS, a $700 million purchase of enriched nuclear fuel, $30 million of capitalized interest, and pay costs of issuance. The bonds do not have a debt service reserve fund.

Fitch also affirms the following outstanding ratings on debt issued by EN and the Port of Morrow and secured by payments from the BPA:

--$1.32 billion Energy Northwest Project 1 electric revenue bonds at 'AA';
--$2.44 billion Energy Northwest Columbia Generating Station electric revenue bonds at 'AA';
--$1.40 billion Energy Northwest Project 3 electric revenue bonds at 'AA';
--$90 million Port of Morrow transmission facilities revenue bonds at 'AA'.

Fitch also affirms its implied non-federal revenue bond rating for BPA at 'AA'.

The Rating Outlook for all bonds is Stable.

SECURITY
The series 2012D & 2012E bonds are secured by an unconditional payment obligation from BPA. The bonds are on parity with EN's outstanding $4.9 billion in electric revenue and Port of Morrow bonds and subordinate to $263.5 million in prior lien bonds (closed lien). BPA's payments to EN and Port of Morrow are made as an operating expense and are paid prior to BPA's payments to the U.S. Treasury (approximately $7.3 billion total in Treasury bonds and federal obligations outstanding as of Sept. 30, 2011). The implied revenue bond rating for BPA reflects its ability to meet its full obligations.

KEY RATING DRIVERS

BONNEVILLE'S OBLIGATION SECURES BONDS: The rating on the EN and Port of Morrow bonds is the same as the implied revenue bond rating for BPA, which reflects its absolute and unconditional obligation to make payments for debt service.

FUEL PURCHASE IS CREDIT NEUTRAL: EN and BPA's advance purchase of enriched nuclear fuel for CGS, funded by the proposed bond issue, is viewed by Fitch as credit neutral. The transaction is expected to provide savings to BPA customers of approximately 1% in rates and counterparty risks appear to have been mitigated to protect ratepayers.

COMPETITIVE WHOLESALE SUPPLIER: BPA has a competitive resource portfolio of over 8,500 MW that provides wholesale electricity (primarily low-cost hydropower) and transmission access to a population of more than 12 million people in the Pacific Northwest.

COST BASED LONG-TERM CONTRACTS: BPA sells its resources through long-term take-and-pay contracts through 2028 that recover cost of service from its 135 preference customers. New contracts went into effect on Oct. 1, 2011 that provide less operational and price risk to BPA than previous contracts.

TIMELY RATE SETTING: BPA has established a two-year rate-setting cycle, with mid-period cost adjustments allowed. BPA also employs an annual cost recovery adjustment clause (CRAC), which adds further rate setting flexibility.

FINANCIAL PRESSURE: BPA's financial performance fluctuates as a result of hydrological conditions and market prices, with secondary (surplus) sales budgeted at 22% of total revenues.

LOW RESERVES: Financial reserves have declined in the past three years due to considerably lower than projected secondary sales and are at very low levels. Power system reserves totaled only $129 million as of Dec. 31, 2011. However, this concern is somewhat mitigated by various financial and rating setting options available to BPA, along with a $750 million federal line of credit with the treasury department, which provides additional liquidity support.

LARGE CAPITAL NEEDS: Recent increases from the federal government in BPA's borrowing capacity for both long-term and short-term needs should fund a portion of its capital needs, but additional funding sources need to be identified.

CREDIT PROFILE
EN, formerly known as the Washington Public Power Supply System, was created in 1957. EN has 28 members, consisting of 23 public utility districts and the cities of Centralia, Port Angeles, Richland, Seattle, and Tacoma, WA. EN owns and operates the Columbia Generating Station (CGS), the Packwood Lake Hydroelectric Project, and the Nine Canyon Wind Project. EN provides electric service to a population of more than 1.5 million in the region.

BPA utilizes the energy from CGS as part of its overall power supply portfolio (approximately 10% of its total capacity) and is obligated to pay debt service on the EN bonds related to CGS, a 1,157-MW operating nuclear plant, and Project 1 and Project 3, non-operating nuclear plants. The other projects owned by EN (wind and hydroelectric) are separately secured and not supported by BPA.

BPA is the largest of the regional federal power marketing agencies within the Department of Energy (DOE). It was created by Congress in 1937 to market electric power from the BPA 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. Its overall portfolio of resources from which it markets power is approximately 8,757 MW, as estimated under low water conditions. Under high water conditions, the fleet may generate more than 12,000 MW.

FUEL PURCHASE TRANSACTION OVERVIEW

EN will use bond proceeds from the series 2012E bonds to purchase a large volume of enriched uranium. The purchased uranium could be used entirely at the CGS and would provide sufficient uranium to fuel the plant through 2038. The CGS license was extended to 2043 by the Nuclear Regulatory Commission (NRC) in May 2012. However, EN has executed a purchase agreement with the Tennessee Valley Authority (TVA; rated 'AAA' with a Negative Outlook by Fitch) wherein, TVA agrees to purchase 435 metric tons of the enriched uranium at fixed prices from EN during the years 2015-2022, thereby reducing the uranium EN expects to retain for use at CGS. Until EN uses the enriched uranium or delivers it to TVA, EN will store the uranium at a DOE facility in Kentucky.

To facilitate the transaction, DOE will deliver 9,082 metric tons of depleted uranium from its storage site in Kentucky to the adjacent enrichment facility operated by the United States Enrichment Corporation (USEC), a private corporation (not rated by Fitch). USEC will enrich the uranium and deliver it back to DOE for long-term storage, on behalf of EN. Upon physical delivery back to DOE and independent verification of the enriched product specifications, EN will make payments to USEC.

DELIVERIES HAVE COMMENCED
Deliveries began in June 2012, financed by a short-term credit facility that EN will repay with long-term bond proceeds. As of July 24, 2012, approximately 50% of the depleted uranium had been delivered by DOE to USEC and 11% of the final delivered product had been delivered by USEC back to DOE for storage. EN has made payment to USEC for delivered amounts. All deliveries must be completed by May 31, 2013, at which time, EN will have made all scheduled payments to USEC, up to a maximum of $700 million.

FUEL COST SAVINGS EXPECTED
BPA estimates that the fuel purchase transaction will provide fuel cost savings to itself and EN of approximately $20 million annually to ratepayers during the years 2014-2027. The fuel savings is generated by DOE's contribution of the depleted uranium at no cost to EN and a low-cost long-term $5 million storage contract to store the enriched uranium through

December 2022. In addition to EN's fuel cost savings, the fuel purchase program provides benefits to other involved parties, including a year-long operating contract for USEC with improved cash flow and delayed workforce reductions, reduced waste disposal costs for DOE for the depleted uranium used in the transaction, and enriched U.S. origin nuclear fuel fixed-price purchase contract for TVA in the years 2015-2022 (as well as extended power sales to USEC for one year, TVA's largest power customer).

COUNTERPARTY RISKS MITIGATED
Risks to EN and BPA from the transaction include operating risk of bankruptcy at USEC prior to the end of the USEC agreement on May 31, 2013, risk of loss of the enriched uranium stored with DOE through 2022, and the failure of TVA to perform according to its purchase obligation between 2015-2022. Given the operating risk of USEC and risks associated with bankruptcy, EN continues to hold title to its depleted uranium that is held on the USEC site and no payment is made to USEC until final delivery of the enriched product. If the full amount of the enriched uranium is not supplied by USEC, TVA's purchase obligation is proportionally reduced and EN retains the unspent bond proceeds.

TVA's obligation to purchase the enriched uranium is supported by its need for U.S. origin nuclear fuel for its own nuclear facilities during the years 2015-2022. Payment from TVA is due prior to EN delivery of the enriched uranium. Failure of TVA to purchase enriched uranium as required by its contract could be mitigated by EN's use of the uranium to fuel CGS or sold in the open market, depending on market prices for enriched uranium at the time. Finally, risk of damage to the physical product while stored with DOE is a risk borne by EN. However, the physical attributes of the massive storage containers make damage from likely events appear low as well as the storage location at a secure federal facility.

For additional information on EN and BPA, please see Fitch's report, 'Energy Northwest; Bonneville Power Administration', dated March 19, 2012.

Contact:

Primary Analyst
Kathy Masterson
Senior Director
+1-415-732-5622
Fitch, Inc.
650 California Street, 4th Floor
San Francisco, CA 94010

Secondary Analyst
Alan Spen
Senior Director
+1-212-908-0594

Committee Chairperson
Dennis Pidherny
Senior Director
+1-212-908-0738

Media Relations: Elizabeth Fogerty, New York, Tel: +1 (212) 908 0526, Email: elizabeth.fogerty@fitchratings.com.

Additional information is available at 'www.fitchratings.com'. The ratings above were solicited by, or on behalf of, the issuer, and therefore, Fitch has been compensated for the provision of the ratings.

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', June 12, 2012;
--'Public Power Rating Guidelines', March 28, 2011.

Applicable Criteria and Related Research:
Revenue-Supported Rating Criteria
U.S. Public Power Rating Criteria