Rating Action: Moody's assigns Aa1 rating to Energy Northwest's Columbia Generating Station (WA) revenue bonds. Outlook is stable

Global Credit Research - 31 Jul 2012

Approximately $775 million of debt securities affected

New York, July 31, 2012 --

Moody's Rating

Issue: Columbia Generating Station Electric Revenue Bonds, Series 2012-D; Rating: Aa1; Sale Amount: $35,000,000; Expected Sale Date: 8/3/12; Rating Description: Revenue: Government Enterprise

Issue: Columbia Generating Station Electric Revenue Bonds, Series 2012-E (Taxable); Rating: Aa1; Sale Amount: $740,000,000; Expected Sale Date: 8/3/12; Rating Description: Revenue: Government Enterprise

Opinion

Moody's has assigned Aa1 ratings to Energy Northwest's $35 million of Columbia Generating Station Electric Revenue Bonds, Series 2012-D and $740 million of Columbia Generating Station Electric Revenue Bonds, Series 2012-E (Taxable). These bonds are supported by net billing agreement with Bonneville Power Administration (BPA, Aa1/stable) and thus are rated the same as BPA's other related obligations. Moody's also affirmed BPA's issuer rating and BPA related ratings comprising of Project No. 1, Columbia Generating Station, Project No. 3, Conservation and Renewable Energy System Conservation Project, Cowlitz Falls Hydroelectric Project, Northwest Infrastructure Financing Corp Transmission Facilities Lease, Port of Morrow Transmission Facilities Revenue Bonds, and Conservation System Project Revenue Bonds. The rating outlook is stable.

Rating Rationale

BPA's Aa1 issuer rating is 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 US Treasury repayment (if necessary). Other factors underpinning the rating are BPA's importance to the US Northwest region, its strong underlying hydro and transmission assets, its competitive power costs and its 17-year power supply contracts with creditworthy public power entities for a large majority of power sales.

BPA strengths are offset by significant hydrology and wholesale power market exposure, environmental burdens and conflicting demands on the Columbia River, a lengthy ratemaking process compared to typical municipal public power entities, a sizeable debt burden due to nuclear projects and pressure on financial reserves and financial metrics. Growing total debt and potential full utilization of the US treasury line by 2016 represent longer term challenges.

Hydrology conditions in the Pacific Northwest and wholesale power prices represent the biggest drivers of volatility to BPA's financial performance. In recent history, these factors, both of which are outside of BPA's control, have contributed heavily to an almost a $1 billion swing in net revenues between the best (2006) and most challenging years (2001). BPA's historically strong internal liquidity was seen as a major risk mitigant and the substantial decline in internal liquidity was a major driver of the rating downgrade to Aa1 from Aaa in August 2011. For fiscal year 2012, regional hydrology is estimated at substantially above average though market prices are low. According to BPA's June 2012 monthly financial report, above average hydrology in June resulted in a revised $44 million in higher total net revenue for FY 2012 than compared to its rate case, which is an improvement from its February 2012's expectation of approximately $80 million below the rate case and May 2012's expectation of $21 million below the rate case.

The Aa1 ratings on BPA's related ratings are based on BPA's contractual obligation to pay under long term agreements.

The stable outlook reflects BPA's unconditional and absolute obligation to pay. BPA's stable outlook incorporates BPA's baseline expectations according to its FY 2012-13 rate case and BPA's near-term ability to withstand difficult market price and hydrology conditions.

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 internal risk reserves resulting in at least 250 days cash on hand on a sustained basis, and if the US Government's rating stabilizes at Aaa. BPA related ratings could be upgraded if BPA is upgraded.

BPA's rating could be negatively pressured if BPA's internal liquidity drops below 30 days cash on hand on a sustained basis, if US government support diminishes, federal constraints are placed on BPA or if the US government ratings are lowered below Aa1. Additionally, BPA related ratings could be downgraded if BPA is downgraded or if the underlying contracts (e.g. net billing agreements) are violated.

Strengths

• BPA benefits from U.S. government support including limited direct borrowing authority with the US Treasury and the legal ability to defer its annual US Treasury repayment if necessary to meet non-Federal debt service commitments (such as Energy Northwest nuclear bonds). 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, a key strategy to ensure timely revenue bond debt service payment

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

• BPA owns and operates 75% of the bulk transmission system in the US Northwest and markets low cost hydroelectric power amounting to 30% of the region's power

• BPA sells a majority of its power under 17-year power supply contracts with creditworthy public power entities and derives roughly a quarter of revenues from a stable electric transmission business

Challenges

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

• Long and complex ratemaking process creates potential complications in timely rate recovery

• Conflicting uses of the 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 meet load and contribute to substantial additional costs

• Energy Northwest's nuclear projects are a sizeable debt burden

• Large debt funded capital program reduces financial flexibility and diminishes US Treasury line availability over the longer term

• Liquidity and financial metrics continue to be pressured by low wholesale prices and volatile hydrology.

• Development of wind energy is likely to exert downward pressure on power prices in the region and has created transmission and load balancing issues

Outlook

The stable outlook reflects BPA's obligations under the net billing agreement to pay for Columbia Generating Station's costs including debt service. BPA's stable outlook incorporates BPA's baseline expectations according to its FY 2012-13 rate case and BPA's near-term ability to withstand difficult market price and hydrology conditions.

What could move the rating -- DOWN

BPA's rating could be negatively pressured if BPA's internal liquidity drops below 30 days cash on hand on a sustained basis, if US government support diminishes, federal constraints are placed on BPA or if the US government ratings are lowered below Aa1. Additionally, BPA related ratings could be downgraded if BPA is downgraded or if the underlying contracts (e.g. 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 internal risk reserves resulting in at least 250 days cash on hand on a sustained basis, and if the US Government's rating stabilizes at Aaa. BPA related ratings could be upgraded if BPA is upgraded.

The principal methodology used in this rating was U.S. Public Power Electric Utilities With Generation Ownership Exposure published in November 2011. Please see the Credit Policy page on www.moodys.com for a copy of this methodology.

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