Public Power
New Issue

Energy Northwest
(Bonneville Power Administration)

Ratings

New Issues

$300.815 Mil. Project 1 Electric Revenue Refunding Bonds, Series 2006-A............ AA–
$432.295 Mil. Columbia Gen. Station Elec. Rev. Refunding Bonds, Series 2006-A..... AA–
$54.530 Mil. Project 3 Electric Revenue Refunding Bonds, Series 2006-A............ AA–
$9.495 Mil. Project 1 Elec. Rev. Refunding Bonds, Series 2006-B*............................ AA–
$5.590 Mil. Columbia Gen. Station Elec. Rev. Refunding Bonds, Series 2006-B* ... AA–
$1.020 Mil. Project 3 Electric Revenue Refunding Bonds, Series 2006-B*............ AA–
$49.085 Mil. Columbia Gen. Station Electric Revenue Bonds, Series 2006-C.............. AA–
$3.310 Mil. Columbia Gen. Station Electric Revenue Bonds, Series 2006-D* .... AA–

Outstanding Debt

Security Class	Current Rating	Previous Rating	Date Changed
Proj. 1 Prior Lien	AA–	AA	3/12/03
Proj. 1 Revenue	AA–	AA	3/12/03
Columbia Prior-Lien	AA–	AA	3/12/03
Columbia Revenue	AA–	AA	3/12/03
Proj. 3 Prior-Lien	AA–	AA	3/12/03
Proj. 3 Revenue	AA–	AA	3/12/03

*Taxable.

Rating Watch.. None
Rating Outlook... Stable

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Key Credit Strengths

- Largest provider of electricity and transmission in the Pacific Northwest.
- Competitive power supply.
- ENW debt service paid prior to U.S. Treasury payments.
- Solid financial performance

Key Credit Concerns

- Volatility associated with hydro system.
- Uncertain long-term rate and contract terms (post 2011).
- Political and litigation uncertainty regarding rates and fish conservation.

March 21, 2006

■ Profile

Energy Northwest (ENW), formerly the Washington Public Power Supply System, has 19 members, consisting of 16 public utility districts and the cities of Richland, Seattle and Tacoma, Wash. ENW owns and operates the Columbia Generating Station (CGS).

Bonneville Power Administration (BPA) is obligated to pay debt service on ENW bonds. BPA is the largest of the regional federal power marketing agencies within the U.S. Department of Energy (DOE). BPA sells and/or exchanges power with more than 100 utilities in the region and with several industrial customers through contracts that expire in 2011. The service area spans 300,000 square miles in the Pacific Northwest and accounts for approximately 40% of the electric power consumed in the region. BPA also owns and operates a high-voltage transmission system, comprising approximately 75% of the bulk transmission capacity in the Pacific Northwest.

■ Rating Rationale

Positive support for the rating is BPA's position as a leading provider of electricity and transmission in the Pacific Northwest and its highly competitive wholesale power rates derived from its hydro-based system. Payments to the U.S. Treasury are subordinate to ENW bonds, providing added security to these obligations. Credit concerns include the risk inherent in a hydro-based system, where available energy and wholesale costs are dependent on weather conditions (e.g., precipitation and water flow). Additional risks involve meaningful regional political differences among BPA's customers (including environmental groups) and a yet to be determined rate structure and BPA service obligation for the period beyond the existing contracts. Fitch Ratings is monitoring other factors, including the 2007 federal budget proposal and ongoing issues regarding fish preservation.

■ Security and New Issue Summary

Fitch assigned an 'AA–'rating to ENW's aggregate $856 million 2006 series A–D revenue bond financings. The Rating Outlook is Stable. Fitch also affirmed ENW's outstanding $2.3 billion prior-lien bonds and $3.8 billion revenue bonds issued in connection with Project 1, CGS and Project 3.

The series 2006 A–D financings consist of taxable and tax-exempt series and involve the three projects mentioned previously. The series 2006 A–D bonds are being issued to refund certain prior-lien and revenue bonds issued by ENW in connection with Project 1, CGS and Project 3 and finance capital expenditures for the CGS. The financings are scheduled to price the week of March 21, 2006, and April 11, 2006, with Goldman Sachs & Co. as senior manager.

The 2006 bonds are payable on a subordinate basis to ENW's outstanding prior-lien bonds. The prior-lien resolution was previously closed. BPA is obligated to pay debt service on the ENW bonds (prior-lien and revenue bonds) before any of its payments to the U.S. Treasury. Hence, ENW's credit rating reflects that of BPA's senior debt rating. BPA's obligations are not general obligations of the United States government and are not secured by the full faith and credit of the United States.

Recent Developments

Over the past year, there have been numerous developments with BPA's credit factors. Fitch believes BPA's credit profile remains solid and that its net credit risk remains consistent for a wholesale provider in the 'AA–' category.

Cash Flow Change

BPA and ENW's are implementing a cash flow proposal, whereby ENW's customers would send their cash payments for costs related to the CGS directly to BPA rather than to ENW, which is the current process under net billing procedures. While the inherent BPA guarantee and obligation through net billing does not go away, Fitch believes the direct pay strategy provides BPA with greater financial flexibility (i.e., more cash, which is particularly important for BPA during the fall months) without substantially reducing ENW's ability to meet its costs. BPA believes that the additional cash flow will allow it to reduce rates 5%–10 %.

Partial Loss of Wholesale Sale Revenues

The current federal budget proposal for 2007 requires BPA to make early payments on its federal debt from any BPA surplus sales in excess of $500 million. Unless the proposal is limited by legislation or amended by the Bush administration, BPA expects the implementation will lead to rates that will be 10% higher in 2008. Legislators and customers in the region are opposed to this proposal. At this time, it is uncertain if this proposal will be implemented.

Continued Fish Preservation Litigation

BPA spent approximately $576 million on fish and wildlife preservation (direct costs and replacement power costs) in fiscal-year 2005. Fitch believes BPA's financial position and credit profile is sufficient to mitigate these financial pressures. Current disputes regarding water flow and spillage to enhance salmon migration cost BPA approximately $70 million–$80 million in 2006 depending on water conditions. Management expects this component of its fish preservation efforts to remain constant over the next year.

Post-2011 Contracts

In September 2005, BPA issued a "concept paper" that described BPA's proposal on all key post-2011 issues relating to new contracts. Its new proposal will attempt to create greater long-term certainty for its rates and encourage its members to meet their growing needs and/or pay for incremental cost to BPA. BPA expects to publish a formal proposal in the *Federal Register* and issue a final policy in late spring 2006. BPA's goal is to offer a new long-term contract by April 2007 and complete rate methodology by October 2008. Key elements of the proposal include:

- 20-year contracts (longer than current 10-year contracts).
- Rate methodology that would restrict amount of power of preference customers, who may purchase at lowest rate equal to output of existing federal system (tier 1).
- Incremental purchasers would be sold at a higher rate, reflecting the cost of incremental load (tier 2).
- A settlement agreement with regional investor-owned utilities (IOUs) that would provide $100 million–$300 million annually in benefits (comparable to existing arrangement).

In general, Fitch views the current proposal and BPA's goals as a positive credit factor and will monitor the development of the contract terms over the next few years.

ENW

ENW has 19 members, consisting of 16 public utility districts and the cities of Richland, Seattle and Tacoma, Wash. ENW owns and operates a nuclear generating station, CGS, with a net design rating of 1,153 megawatts (mw), the Packwood Lake Hydroelectric Project and the Nine Canyon Wind Project. The CGS is licensed to operate until 2023.

Fitch views the CGS as a reliable generating unit, although in 2005 CGS experienced three forced outages. Prior to the outages, in 2004–2005, the CGS set a station record for 393 days of consistent operations.

The price of CGS's electricity was 3.34 cents per kilowatt-hour (kwh) during fiscal-year 2005, which was higher than normal due to the 2005 outages (the cost of electricity was 2.19 and 3.01 cents per kwh in the prior two years and is projected to be 2.10 cents/kwh for the current fiscal year). ENW is working on a proposal to extend CGS's 40-year operating license by 20 years to 2043 from 2023. Current estimates for plant decommissioning and site restoration are $690 million and $90 million, respectively. ENW annually funds these obligations. Current balances in ENW's decommissioning and site restoration trust funds are considered adequate at this time ($92 million and $11 million, respectively).

■ BPA

BPA is the largest of the regional federal power marketing agencies within the DOE. In 1996, BPA separated its power marketing function from its transmission system operation and electric system reliability functions. BPA remains a single legal entity, but it now conducts its business as separate business lines: the power business line and the transmission business line.

Power Supply

BPA's power supply is primarily hydro-based (90% of energy) and derives from 31 federally owned hydroelectric projects, most of which are located in the Columbia River Basin (approximately 9,000 average mw under medium water conditions) and from several nonfederally owned and operated projects, including the nuclear-fueled CGS. These resources are referred to as the federal system. The hydro projects were constructed and are operated by the U.S. Army Corps of Engineers or the Bureau of Reclamation.

Fiscal-year 2005 marked the sixth consecutive year of below-average water flow. Positively, the outlook for fiscal-year 2006 is better, with hydrological conditions forecasted to be close to average.

Transmission

The federal transmission system is composed of approximately 15,000 circuit miles of high-voltage transmission lines and more than 300 substations that are located in Washington, Oregon, Idaho and parts of Montana, Wyoming and northern California. A southern intertie consists of three high-voltage alternating current (AC) transmission lines and one direct current (DC) transmission line that interconnect the electric systems of the Pacific Northwest and Pacific Southwest. The rated transfer capability of the southern intertie AC in the north-to-south direction is 4,800 mw of capacity, and in the south-to-north direction is 3,675 mw. The rated transfer capability of the DC line in both directions is 3,100 mw.

■ BPA Service Area and Customers

BPA's primary customer service area is the Pacific Northwest region of the United States, encompassing Idaho, Oregon Washington, parts of western Montana and small parts of western Wyoming, northern Nevada and northern California. BPA sells electric power in a 300,000 square mile service area, with a total serviced population of approximately 11 million people.

BPA sells and/or exchanges power with more than 100 utilities in the region and with several industrial customers through contracts that expire in 2011. BPA has four major customer classes:

- Preference customers, which account for 62% of electric sale revenues, including municipal utilities, public utility districts and rural electric cooperatives.
- Regional IOUs, which account for 14% of electric sale revenues, including BPA's low-cost power supply benefits to the residential and small-farm customers of six regional IOUs. BPA and the IOUs agreed to a settlement that satisfies BPA's obligation through financial payments through 2011 (approximately $100 million–$300 million per year).
- Regional customers, which account for 22% of electric sale revenues, consisting of surplus firm and nonfirm power sales, primarily to California utilities.
- Direct service industries (DSIs), which account for 3% of electric sale revenues, including electric sales directly to aluminum and processing facilities.

The Northwest Power Act requires BPA to meet certain firm loads in the Northwest of various preference customers and regional IOUs. BPA does not have an obligation to meet all firm loads within the region or enter into contracts to sell any power to DSIs but has opted to do so historically for the economic well-being of the region. BPA sells preference customers four basic power products:

- Block sales, under which BPA provides five-year fixed blocks of power at agreed times on a take-or-pay basis.
- Slice of the system, which is a form of requirements service in which BPA sells a proportion of federal system output, both firm power and seasonal surplus energy, in return for a promise of the customer to pay a correlative proportion of the cost of the federal system.
- Partial-requirement sales.
- Full-requirement sales.

Under these agreements, BPA is obligated to provide approximately 7,200 average mw to meet preference customer loads through fiscal-year 2011. Of this amount, approximately 1,600 average mw are sold as slice of the system products, approximately 2,200 average mw are in the form of block sales and the remainder (3,400 mw) is in the form of full- or partial-requirement products.

■ BPA Rates

BPA's rates are subject to extensive review by outside parties, which differentiates BPA's credit from municipal wholesale utilities (often self-regulated). Rates proposed by BPA are reviewed by the Federal Energy Regulatory Commission (FERC). After FERC approval, rates may be reviewed by the U.S. Court of Appeals. Actions seeking such review must be filed within 90 days of the final FERC decision.

Power Supply

In 2001, BPA enhanced its ability to recover costs, utilizing three intrarate period adjustments (cost-recovery adjustment clauses) that are enacted upon the occurrence of specific circumstances. The adjustments increased electric rates to 29–30 mills/kwh from the base preference rate of 22 mills/kwh. BPA's existing rate structure expires at the end of fiscal-year 2006, and BPA is in the process of developing new rates for fiscal-years 2007–2010. The most significant changes proposed by BPA involve the use of a single adjustment triggered annually based on modified net revenue deficits (see below) and BPA's proposal to physically serve only 17 average mw of direct service industrial load.

Transmission

In October 2005, BPA enacted a 12.5% rate increase for transmission rates for two-years. This increase translates into 1%–2% overall rate increase. The reason for the increase was a shortfall of transmission sales and additional costs associated with reliability projects.

■ BPA Finances

BPA's finances stabilized over the past few years. In fiscal-year 2005, BPA's debt-service coverage for its ENW obligations (both prior-lien and revenue bond lien) was more than 4.5 times (x). Coverage of all of its ENW and U.S. Treasury obligations was 1.1x. BPA deferred its payments to the U.S. Treasury only once in 1983.

For fiscal-year 2005, BPA had positive net revenues of approximately $486 million compared with $504 million the year before. Modified net revenues (which are a measure of operational margins that does not include certain financial adjustments) show an increase of net margins over the past three years. Modified net revenues for fiscal-year 2005 were $126 million, compared with $66 million and $33 million for fiscal-years 2004 and 2003, respectively. In addition, for the fiscal year-end 2005, BPA had approximately $554 million in financial reserves (equal to more than three months of operating expenses).

Financial Summary — Bonneville Power Administration
($000, Years Ended Sept. 30)

	2005	2004	2003
Non-Federal Projects Debt-Service Coverage (x)	4.58	5.29	11.00
BPA Aggregate Debt-Service Coverage (x)	1.06	1.08	1.20
Total BPA Debt/Funds Available for Debt Service (x)	10.2	10.5	10.4
Days Cash On Hand	110	133	82
Equity/Capitalization (%)	8.9	5.8	2.5
Total Operating Revenues	3,268,083	3,197,911	3,612,104
Total Operating Expenses	2,212,389	2,160,170	2,591,555
Operating Income	1,055,694	1,037,741	1,020,549
Funds Available for Debt Service	1,336,698	1,314,528	1,315,309
Total Annual Debt Service (ENW)	291,540	248,475	119,534
Total Annual Adjusted Debt Service (BPA)	1,263,560	1,215,976	1,095,216
Total Cash	554,000	654,242	503,026
Total Debt	13,612,450	13,798,089	13,665,307
Equity and/or Retained Earnings	1,334,294	847,424	343,748

BPA – Bonneville Power Administration. ENW – Energy Northwest. Source: Company reports.