Moody's Investors Service

Global Credit Research
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New Issue: Tacoma (City of) WA

MOODY'S ASSIGNS Aa1 CREDIT RATING TO CITY OF TACOMA CONSERVATION SYSTEM PROJECT REVENUE REFUNDING BONDS

BONDS BACKED BY BONNEVILLE TAKE-OR-PAY OBLIGATION

Municipality
WA

Moody's Rating

ISSUE		UNDERLYING RATING	RATING
Conservation System Project Revenue Refunding Bonds, 2003		Aa1	Aa1
Sale Amount	$17,660,000		
Expected Sale Date	05/12/03		
Rating Description	Conservation System Project Revenue Refunding Bonds, 2003		

Opinion

NEW YORK, May 8, 2003 -- Moody's Investors Service has assigned the credit rating of Aa1 to the City of Tacoma Conservation System Project Revenue Refunding Bonds, Series 2003 expected to price May 12. The bonds will refund the Conservation System Project Revenue Refunding Bonds, 1994 for present value savings. The current offering is secured by the Conservation Project Agreement of the Bonneville Power Administration to pay the debt service on the 2003 bonds whether or not the Conservation System Project is terminated, operating, or operable.

The strong take-or-pay agreement between BPA and Tacoma as security for the bonds is payable by BPA from the Bonneville Fund on a parity basis with other BPA take-or-pay power purchase contracts such as the net billed project costs which are superior to BPA's payments made to the U. S. Treasury. The take-or-pay agreement includes the provision that BPA pays debt service directly to the Trustee, five days in advance of the due dates. Moody's maintains a credit rating of Aa1 on Energy Northwest's net billed project bonds which are on parity with BPA's obligation for the current offering.

Moody's has assigned the Aa1 credit rating to the current offering after evaluating the following considerations:

CREDIT RATING REFLECTS STRONG TAKE-OR-PAY OBLIGATION OF THE BONNEVILLE POWER ADMINISTRATION

BPA is one of four regional federal power marketing agencies within the U.S. Department of Energy. BPA is required by federal law to meet certain energy requirements in the Northwest region, to implement conservation measures and provide transmission services. Moody's believes that the U.S. Government's implied support of the current offering through BPA is a key credit factor. While the current offering is not a direct U.S. government obligation, the contractual payments by BPA to support the debt service have implied federal support through BPA.

BPA's important role and status as an Energy Department line agency is an important consideration. Moody's finds credit strength in BPA's ties to the federal government. BPA has direct borrowing authority for $4.45 billion with repayment terms at market rates of interest with the U.S. Treasury (Congress approved in 2003 a $770 million increase in BPA's borrowing authority from the previous level of $3.75 billion), and BPA has repayment flexibility on those borrowings if needed; BPA also has a Fish Cost Contingency Fund.

BPA markets electric power from the 30 federally-owned hydroelectric facilities constructed on the Columbia and Snake Rivers providing 46% of the electric power in the Pacific Northwest. Power dispatched from Energy Northwest's Columbia Nuclear Generating Station No. 2 represents about 11% of BPA's total energy resources. BPA owns and operates 75% of the bulk electric power transmission, and 80% of the transmission capacity of the Pacific Northwest-Pacific Southwest Intertie. BPA is also responsible for significant regional environmental protection programs as well as for coordinating river operations and treaty responsibilities with Canada. BPA has funded 70% of the fish and wildlife mitigation and recovery efforts in the Columbia Basin. A BPA failure would have far-reaching effects on the region. Moody's believes BPA's importance is attested to by the strong political support it enjoys in Congress and by the numerous federal statutes that have been enacted involving BPA to resolve energy issues in the region.

BPA'S STRONG MANAGEMENT MET CHALLENGE OF POSITIONING FOR DEREGULATION; SAME STRENGTHS EVIDENT IN REGIONAL POWER CRISIS

Moody's credit rating recognizes that BPA management has demonstrated a capacity to deal with major challenges. BPA management, for example, anticipated a more competitive electricity market and aggressively positioned the organization for electric industry deregulation, while maintaining a strong financial position. BPA did not rely on its access to federal funds, but implemented in the mid 1990s a strategic plan that remained on track through 2001 to position the agency's cost structure for more competitive markets while maintaining strong financial reserves. For example, management trimmed an average $600 million in expenses from the BPA annual budget out of a 1996-2001 forecasted expenditure base of $3 billion, including a staff reduction of 20%. BPA was able to lower its wholesale rate to 2.44 cents/kwh, well below the original forecasted rate in the 3 to 3.5 cents/kwh range. The lower BPA cost structure positioned BPA favorably as it began to undertake negotiations for the new power sale contracts that would begin October 1, 2001, for the 2002-2006 period. The success of the BPA strategic plan and the regional recognition of BPA's strengths was evident in the significant increase in the number of customers and their requests to purchase power from BPA for the 2002-2006 period. To meet the excess power sales above the federal generation system, BPA had to purchase power since there wasn't adequate federal system generation.

The Pacific Northwest faced unprecedented circumstances in 2000-2001 regarding power supplies and costs. The region's hydro-based system experienced drought conditions, with water volumes estimated by BPA to be the second lowest level since 1929. In the meantime the dysfunctional regional market, partly caused by the industry deregulation failure in California, caused prices to rise to extreme and unprecedented levels. BPA decided to substantially avoid the day-to-day volatile wholesale energy market to meet a portion of its load obligations by contracting short-term with regional power suppliers to insure power supply reliability for the region. While BPA met the objective of electricity reliability, it came at a cost with average power prices increasing well above forecast.

In Moody's opinion, BPA management did respond effectively to the 2000-2001 crisis with a strategy to maintain its financial health which included a high probability of meeting Treasury payments, maintenance of the integrity of the federal 2000 Biological Opinion and maintenance of cash reserve levels. BPA increased power rates significantly to insure it maintained its financial health.

DROUGHT AND REMAINING POWER MARKET UNCERTAINTY CONTINUE AND THE CHALLENGE TESTS BPA'S FINANCIAL STRENGTHS; FISCAL YEAR 2003 STRATEGIES INCLUDE SAFETY NET POWER RATE INCREASE

As water conditions remained low through 2002 and into 2003 (70% to 75% of average) and the regional power market remained volatile, BPA's financial operations faced challenges. The combination of the higher than expected power purchase expenses due to low water conditions, and high wholesale energy prices and the lower than expected power sales revenue from surplus sales due to low water conditions continue to caused significant impacts to BPA's financial condition. Audited actual financial results for FY 2002 reflected negative net revenues of $308 million, which improves to positive $9.4 million when the debt optimization change is considered. Financial reserves were at a low $188 million, down from the 2001 level of $625 million. A notable strength was the Non-Federal Project debt service coverage, which improved to 4.90 times. BPA did meet its FY 2002 payment obligation to the U.S. Treasury for the 19th consecutive year. These financial results were achieved despite the unprecedented combination of low water conditions and the volatile regional energy marketplace.

BPA has identified various stress conditions in its forecasting for the 2003-2006 period and has now focused attention on actions to narrow future revenue gaps assuming water conditions remain lower than average. BPA management has begun implementing various cost reductions ($140 million reductions made in BPA's internal operating costs and a freeze on power-related operating costs at the FY 2001 level without inflation adjustments, for example, in 2003) and assessing others such as contract re-negotiation, settlement of litigation and more cost effective fish recovery programs. BPA is reviewing changing its long standing goal of achieving an 88% five year Treasury payment probability in the development of new power rates. The rates, based on BPA's Safety Net Cost Recovery Adjustment Clause, are expected to be variable based on recovery requirements and represent an average increase of 15% starting in October 2003. Power rates will then be $37/Mwh. BPA has begun the regulatory process to introduce and hold public hearings on the new rate structure.

BPA also used several important financial tools which have been significant factors in stabilizing its financial position throughout the 2000-2001 period. BPA has access to liquidity of over $1 billion which it has legal authority to utilize if needed. While BPA is faced with the challenge of bridging the current revenue gap, management responsiveness on rates and cost cutting is a favorable consideration. While there is considerable upside to the financial forecasts should water conditions improve, uncertainty is conservatively built into BPA forecasts particularly for FY 2003.

Outlook

Moody's has assigned a stable credit outlook. BPA business fundamentals continue to be sound despite financial challenges resulting from the impacts of the deregulated wholesale energy market. BPA management has continued to demonstrate the same level of strength during the past year in managing through the energy crisis in the Pacific Northwest as it did in its initial preparation for electric industry deregulation.

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